

2350
2353

United States Circuit Court of Appeals For the Ninth Circuit.

CHARLES C. MOORE, F. W. BRADLEY, MAURICE SCHWEITZER, R. D. ROBBINS and WALTER
MARTIN, Interveners,

vs.

Appellants,

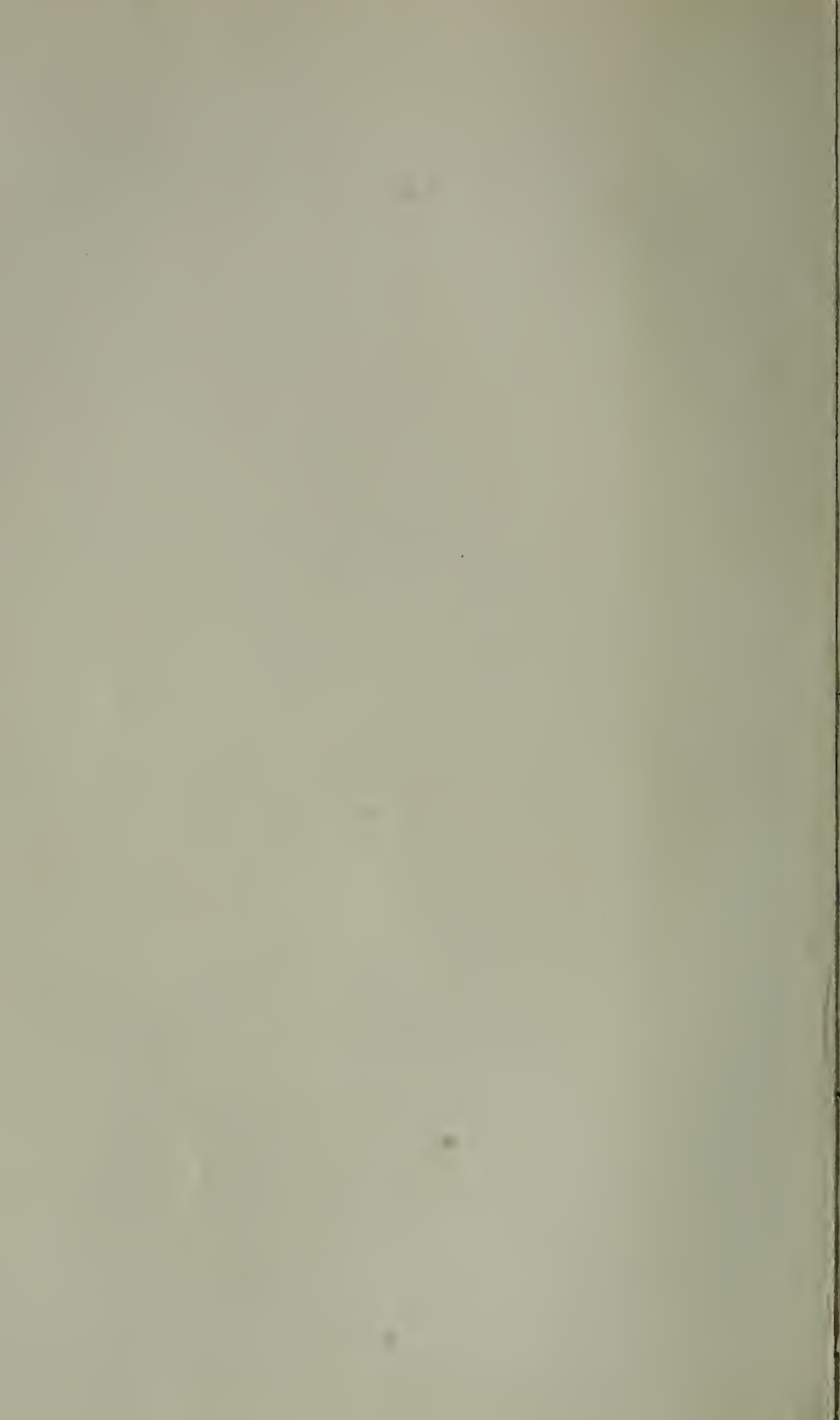
L. DONAHOO, L. T. COATES, H. L. STAPLES, MRS. J. E. SHILLADEY, C. E. BASS, J. L. WHISSEN, H. L. GOODLOE, R. J. ELLIS, OLIVER W. HALL, E. G. GRAY, S. K. WOODBURN, FRED L. SPARKS, O. J. EFFENBECK, J. A. ROIN, W. N. SILSBY, W. D. WILCOX, F. A. STOKEL, WM. A. ROIN, J. MATTHEWS, J. W. GRAY, F. H. SAGE, OSCAR S. WESTBERG, R. P. STANDLEY, W. B. SCOTT, H. HORN, C. BECKER, GEORGE V. AGNEW, D. W. BAILE, J. W. CARTER, C. CONTO, L. LUCAS (or LUKAS), F. J. LYONS, JOHN J. DAKE, HENRY ROS NBLAD (or ROSENILATT), DANIEL KEITH, M. H. LAWSON, JOHN KENNEDY, NAVIER PASQUALINE, C. F. TWISSELMAN, E. P. SHILLADEY, FRED DELIN, D. R. PARSLEY, S. GEORGE, M. MOELLER, S. F. DART, A. POULOS, JOHN CONTO, J. VORIGACHIS, CHARLES T. FAUCETT, PATRICK CAVANAUGH, JAMES ROSAR, A. E. SIEBEL (or SIEGEL), A. J. AULT, F. J. BETTINGER, N. LOUTO, GEORGE DOODY, R. H. SHAVES, J. MARKIS, J. METZGER, F. J. REEDY, C. E. WILCOX, E. L. BRASSWELL, CHRIS ECONOMOU (or CONOMU), GUS KOSTAKIS, F. LEGOURIOUS (LEGORIS), N. SPIROS, MIKE POPOVITZ, P. JUDAS, C. PAPPAS, J. GERGUSIAKIS, P. DRULIS, C. PAPPAS, N. PAPAOSTOLI, P. NICK OLAS, P. PAULIS, J. PAULIS, J. KAFOLAS, P. MILES, P. KAFOLAS, J. PANDACIS, M. PANOS, M. SIMON, J. G. JAMES CO., WM. C. KNOX, CHAS. H. WILSON, C. B. JOHNSON, LOUIS LAIT, T. E. VANOMEN, AUG. JOHNSON, DR. A. S. KEENAN, P. O'FARRELL, J. F. CIBLIN, FAIRBANKS, MORSE & CO., J. HOMER FRITCH, INC., W. L. HOLMAN CO., REMINGTON TYPEWRITER CO., ACME LUMBER CO., E. W. THOMAS OIL BURNER CO., WESTERN BUILDING MATERIAL CO., SAN FRANCISCO GAS & ELECTRIC CO., SOUTHERN PACIFIC COMPANY, DR. J. C. SPENCER, E. MOULTY, JOHN HURLEY, MARY KNIGHTS, COLITA CHATARD, CLARA FERINI, W. P. GEARY, JOHN NORIEGA, E. L. SMITH, J. H. HURLBUT, W. J. BERGER, DR. ALBERT B. McKEE, DRS. PHILLIPS & PHILLIPS, DR. W. A. BROOKS (or BROOKE), CLARA GREENE, L. C. GREENE, FRANCIS M. SELLERS, DR. H. (or E. H.) DANMANN, A. L. GEGGUS, J. W. CROSBY, J. M. GILBERT, P. P. CHATARD, H. V. RIPPON, CARL SAGER, METTA E. STROSS, C. N. COMPTON, LOUIS ZACHERT, GUS D. HURLBUT, FRANK L. SAWYER, W. M. BOEKEN, MARY J. HANLEY, E. T. CHARLTON, CHAS. E. CROLY, W. N. FRYE, SIDNEY SPROUT, SMITH EMERY CO., F. A. HINN CO., AUSTRALIAN HARDWOOD CO., CALIFORNIA LITHO. CO., A. CARLISLE & CO., S. F. CALL, DOW PUMP ENG. CO., ECCLES & SMITH CO., JOHN FINN METAL WKS., GENERAL ELECTRIC CO., GALLAGHER & MOTTS, GREAT WESTERN SMELTING & REFINING CO., HOLMES LIME CO., G. M. JOSSELYN & CO., L. KINGSWELL, PECK-JUDAH CO., J. A. ROEBLING'S SONS CO., SQUIRE & BYRNE, ENTERPRISE FOUNDRY CO., WHITE BROTHERS, PINKERTON'S NATIONAL DETECTIVE AGENCY, DR. W. C. HOPPER, HELEN W. LEE, E. S. REINOEHL, THOS. DAY CO., FT. PITT SPRING MFG. CO., GOULD COUPLER CO., JOOST BROS., SMITH COPPER WORKS, FRED WARD & SON, ERNEST DE TEMPLE, L. & M. ALEXANDER & CO., SANTA CRUZ WATER WKS., F. G. BARCLAY, CHARLES BUTLER, M. J. HOWE, P. LONG, D. J. MCGOWAN, M. J. McGUIRE, JAMES MILLS, TIMOTHY O'DRISCOLL, THOS. J. O'KEEFE, C. O. REEVES, M. R. TWOMEY, THOMAS H. WILLIAMS, MICHAEL ALBRECHT, JOHN FITZPATRICK, PATRICK GALVIN, THOMAS E. HANLEY, J. W. MANNING, WM. A. STOLE, PETER WHITE, CHARLES COLSON, LOUIS IRONS, CHAS. W. BAKER, WM. O'PPERSON, K. O. WHITSON, H. P. THOMAS, E. P. LENOX, JOHN KENNY, WM. A. DOYLE, F. L. BERRY, E. L. (or G. L.) DUNCAN, I. W. FLEMING, J. S. GROW, THOMAS HEWITT, L. WELCH, A. ENGELSON, WM. H. BAXTER, T. M. DALY, H. P. ELLIOTT, C. W. FINCH, M. E. HALE, J. J. HIGGINS, M. S. KENTZELL, OWEN LARKIN, G. (or J.) PRIOLA, A. SHILLING, S. L. KAMP-SCHMIDT, F. F. ROAKE, GEORGE G. SMITH, F. L. BROWNE, JAS. CASPER, H. H. McFEWEN, CHARLES JARVIS, H. H. JORDAN, J. L. CUNNINGHAM, J. O. FRAIN, F. W. CASSIDY, S. J. MURPHY, PETER JOHNSON, J. H. MURPHY, B. T. (or B. F.) COWGILL, COFFIN, REDINGTON & CO., W. P. FULLER & CO., GORHAM RUBBER CO., PACIFIC HARDWARE & STEEL CO., SCHWABACHER-FREY STA. CO., SELBY SMELTING & LEAD CO., GEO. H. TAY CO., A. L. YOUNG MACH. CO., ZELLERBACH PAPER CO., POSTAL TELEGRAPH CABLE CO., WESTINGHOUSE AIR-BRAKE CO., WESTINGHOUSE TRACTION BRAKE CO., SIMPLEX RY. APPLIANCE CO., S. K. MITSUSE, C. P. MOSCONI, S. SKLIRIS, N. PARIS, PATRICK MOLONEY, Trustee of the Estate of C. O'CONNOR, Deceased, MICHAEL CLARK, GERTRUDE H. COLLINS, BOYCE LUMBER CO., E. J. BOYCE, MARY E. BATES, D. E. BESEKER, PACIFIC STATES FLEC. CO., KNOX COLLECTION AGENCY, F. O. REED (Assignee), J. MILLER (Assignee), A. S. LOZIER, A. KINAFOTOS, SPRING VALLEY WATER CO., GIBSON & WOOLNER, R. P. ASHE, I. S. CHAPMAN, WILLIAMSON & DIBBLEE, WALTER CHRISTIE, O'DONNELL, L. T. JACKS, W. B. BOSLEY, and LEO H. SUSSMANN, C. A. STRONG, F. M. HULTMAN, J. P. LANGHORNE & RICHARD BAYNE, R. S. NORMAN, L. T. HENGSTLER, CHAS. J. HEGGERTY, CUSHING & CUSHING, J. R. PRINGLE, W. H. BARROWS, J. C. CAMPBELL, WM. A. NUNLIST, OTHELLO C. PRATT, WEINMANN, WOOD & CUNHA, W. C. GRAVES, S. C. WRIGHT, C. E. LINDSAY, NEAL POWER, KENNEDY & KIRK, MARSHALL NUCKOLLS, JOHN O. McELROY, M. R. CAREY, SULLIVAN & SULLIVAN, and THEO. J. ROCHE, GOODFELLOW, BILLS & ORRICK, H. M. WRIGHT (Master), F. S. STRATTON, as Receiver of Ocean Shore Railway Company, and MERCANTILE TRUST COMPANY OF SAN FRANCISCO,

Appellees.

Transcript of Record **FILED**

JAN 17 1914

Upon Appeal from the United States District Court
for the Northern District of California,
Second Division.



United States
 Circuit Court of Appeals
 For the Ninth Circuit.

CHARLES C. MOORE, F. W. BRADLEY, MAURICE SCHWEITZER, R. D. ROBBINS and WALTER S. MARTIN, Interveners,

Appellants,

vs.
 F. L. DONAHOO, L. T. COATES, H. L. STAPLES, MRS. J. E. SHILLADEY, C. E. BASS, J. L. WILSSEN, H. L. GOODLOE, R. J. ELLIS, OLIVER W. HALL, E. G. GRAY, S. K. WOODBURN, FRED L. SPARKS, O. J. EFFENBECK, J. A. ROIX, W. N. SILSBY, W. D. WILCOX, F. A. STOEKEL, WM. A. ROIX, J. MATTHEWS, J. W. GRAY, F. H. SAGE, OSCAR S. WESTBERG, R. P. STANDLEY, W. B. SCOTT, H. HORN, C. BECKER, GEORGE W. AGNEW, D. W. BALE, J. W. CARTER, C. CONTO, L. LUCAS (or LUKAS), F. J. LYONS, JOHN J. DAKE, HENRY ROSENBLAD (or ROSENBLATT), DANIEL KEITH, M. H. LAWSON, JOHN KENNEDY, XAVIER PASQUALINE, C. E. TWISSELLMAN, E. B. SHILLADEY, FRED HELIN, D. R. PARSLEY, S. GEORGE, M. MOELLER, S. F. DART, A. POULOS, JOHN CONTO, J. VORIGACHIS, CHARLES T. FAUCETT, PATRICK CAVANAUGH, JAMES ROSAR, A. E. SIEBEL (or SIEGEL), A. J. AULT, F. J. BETTINGER, N. LOUTO, GEORGE DOODY, R. H. SHAVES, J. MARKIS, J. METZGER, F. J. REEDY, C. E. WILCOX, E. L. BRASSWELL, CHRIS ECONOMOU (or CONOMU), GUS KOSTAKIS, F. LEGOURIOUS (LEGORIS), N. SPIROS, MIKE POPOVITZ, P. JUDAS, C. PAPPAS, J. GERGUSIAKIS, P. DRULIS, C. PAPPAS, N. PAPAPOSTOLU, P. NICKOLAS, P. PAULIS, J. PAULIS, J. KAFOLAS, P. MILES, P. KAFOLAS, J. PANDACES, M. PANOS, M. SIMON, J. G. JAMES CO., WM. C. KNOX, CHAS. H. WILSON, C. B. JOHNSON, LOUIS LAIT, T. E. VANOMEN, AUG. JOHNSON, DR. A. S. KEENAN, P. O'FARRELL, J. F. GIBLIN, FAIRBANKS, MORSE & CO., J. HOMER FRITCH, INC., W. L. HOLMAN CO., REMINGTON TYPEWRITER CO., ACME LUMBER CO., E. W. THOMAS OIL BURNER CO., WESTERN BUILDING MATERIAL CO., SAN FRANCISCO GAS & ELECTRIC CO., SOUTHERN CALIFIA CHATARD, CLARA FERINI, W. P. GEARY, JOHN NORIEGA, E. L. SMITH, J. H. HURLBUT, W. J. BERGER, DR. ALBERT B. MCKEE, DRS. PHILLIPS & PHILLIPS, DR. W. A. BROOKS (or BROOKE), CLARA GREENE, L. C. GREENE, FRANCIS M. SELLERS, D. H. (or E. H.) DANMANN, A. L. GEGGUS, J. W. CROSBY, J. M. GILBERT, P. P. CHATARD, H. V. RIPPON, CARL SAGER, METTA E. STROSS, C. N. COMPTON, LOUIS ZACHERT, GUS D. HURLBUT, FRANK L. SAWYER, W. M. BOEKEN, G. N. COMPTON, LOUIS ZACHERT, GUS D. E. CROLY, W. N. FRYE, SIDNEY SPROUT, SMITH EMERY CO., F. A. HINN CO., AUSTRALIAN HARDWOOD CO., CALIFORNIA LITHO. CO., A. CARLISLE & CO., S. F. CALL, DOW PUMP ENG. CO., ECCLES & SMITH CO., JOHN FINN METAL WKS., GENERAL ELECTRIC CO., GALLAGHER & MOTTS, GREAT WESTERN SMELTING & REFINING CO., HOLMES LIME CO., G. M. JOSSELYN & CO., L. KINGSWELL, PECK-JUDAH CO., J. A. ROEBLING'S SONS CO., SQUIRE & BYRNE, ENTERPRISE POUNDRY CO., WHITE BROTHERS, PINKERTON'S NATIONAL DETECTIVE AGENCY, DR. W. C. HOPPER, HELEN W. LEE, E. S. REINORHL, THOS. DAY CO., FT. PITT SPRING MFG. CO., GOULD COUPLER CO., JOOST BROS., SMITH COPPER WORKS, FRED WARD & SON, ERNEST DE TEMPLE, L. & M. ALEXANDER & CO., SANTA CRUZ WATER WKS., F. G. BARCLAY, CHARLES BUTLER, M. J. HOWE, P. LONG, D. J. MCGOWAN, M. J. MCGUIRE, JAMES MILLS, TIMOTHY O'DRISCOLL, THOS. J. O'KEEFE, C. O. REEVES, M. R. TWOMEY, THOMAS H. WILLIAMS, MICHAEL ALBRECHT, JOHN FITZPATRICK, PATRICK GALVIN, THOMAS E. HANLEY, J. W. MANNING, WM. A. STOLL, PETER WHITE, CHARLES COLSON, LOUIS IRONS, CHAS. W. BAKER, WM. OTTERSON, K. O. WHITSON, H. P. THOMAS, E. P. LENOX, JOHN KENNY, WM. A. DOYLE, F. L. BERRY, E. L. (or G. L.) DUNCAN, I. W. FLEMING, J. S. GROW, THOMAS HEWITT, L. WELCH, A. ENGELSON, WM. H. BAXTER, T. M. DALY, H. P. ELLIOTT, C. W. FINCH, M. E. HALE, J. J. HIGGINS, M. S. KENTZELL, OWEN LARKIN, G. (or J.) PRIOLA, A. SHILLING, S. L. KAMP-SCHMIDT, F. F. ROAKE, GEORGE G. SMITH, F. L. BROWNE, JAS. CASPER, H. H. McEWEN, CHARLES JARVIS, H. H. JORDAN, J. L. CUNNINGHAM, J. O. FRAIN, F. W. CASSIDY, S. J. MURPHY, PETER JOHNSON, J. H. MURPHY, B. T. (or B. F.) COWGILL, COFFIN, REDINGTON & CO., W. P. FULLER & CO., GORHAM RUBBER CO., PACIFIC HARDWARE & STEEL CO., SCHWABACHER-FREY STA. CO., SELBY SMELTING & LEAD CO., GEO. H. TAY CO., A. L. YOUNG MACH. CO., ZELLERBACH PAPER CO., POSTAL TELEGRAPH CABLE CO., WESTINGHOUSE AIR-BRAKE CO., WESTINGHOUSE TRACTION BRAKE CO., SIMPLEX RY APPLIANCE CO., S. K. MITSUSE, C. P. MOSCONI, S. SKLIRIS, N. PARIS, PATRICK MOLONEY, Trustee of the Estate of C. O'CONNOR, Deceased, MICHAEL CLARK, GERTRUDE H. COLLINS, BOYCE LUMBER CO., E. J. BOYCE, MARY E. BATES, D. E. BESECKER, PACIFIC STATES ELEC. CO., KNOX COLLECTION AGENCY, F. O. REED (Assignee), J. MILLER (Assignee), A. S. LOZIER, A. KINAFATOS, SPRING VALLEY WATER CO., GIBSON & WOOLNER, R. P. ASHE, I. S. CHAPMAN, WILLIAMSON & DIBBLEE, WALTER CHRISTIE, O'DONNELL, L. T. JACKS, W. B. BOSLEY, and LEO H. SUSSMANN, C. A. STRONG, F. M. HULTMAN, J. P. LANGHORNE & RICHARD BAYNE, R. S. NORMAN, L. T. HENGSTLER, CHAS. J. HEGGERTY, CUSHING & CUSHING, J. R. PRINGLE, W. H. BARROWS, J. C. CAMPBELL, WM. A. NUNLIST, OTHELLO C. PRATT, WEINMANN, WOOD & CUNHA, W. C. GRAVES, S. C. WRIGHT, C. E. LINDSAY, NEAL POWER, KENNEDY & KIRK, MARSHALL NUCKOLLS, JOHN O. McELROY, M. R. CAREY, SULLIVAN & SULLIVAN, and THEO. J. ROCHE, GOODFELLOW, EELLS & ORRICK, H. M. WRIGHT (Master), F. S. STRATTON, as Receiver of Ocean Shore Railway Company, and MERCANTILE TRUST COMPANY OF SAN FRANCISCO,

Appellees.

Transcript of Record.

Upon Appeal from the United States District Court
 for the Northern District of California,
 Second Division.

INDEX TO THE PRINTED TRANSCRIPT OF RECORD.

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur. Title heads inserted by the Clerk are enclosed within brackets.]

	Page
Admission of Service of Citation.....	160
Agreed Statement	1
Assignment of Errors.....	132
Bond on Appeal.....	145
Certificate of Clerk U. S. District Court to Transcript of Record.....	150
Citation on Appeal.....	152
Decree Confirming Master's Report on Debts Accruing Prior to the Appointment of the Receiver and During the Receivership.....	106
EXHIBITS:	
Exhibit "A"—To Agreed Statement—List of Claims, etc.....	41
Exhibit "B"—To Agreed Statement—List of Claims, etc.....	48
Exhibit "C"—To Agreed Statement—List of Persons Entitled to Certain Payments	51
Exhibit "D"—To Agreed Statement—Order Permitting Sale of Properties....	52

Index.

Page

EXHIBITS:

Exhibit "E"—Agreed Statement—Opinion
on Exceptions to Master's Report. 99

Notice of the Trustee's Sale of the Properties of
the Ocean Shore Railway Company Under
Permission of the Circuit Court of the
United States. 88

Order Approving and Allowing Agreed State-
ment 41

Order Enlarging Time to October 15, 1913, to
File Record 164

Order Enlarging Time to November 14, 1913, to
File Record 165

Order Enlarging Time to December 13, 1913, to
File Record 167

Order Enlarging Time to January 2, 1914 to File
Record 168

Order Permitting an Appeal and Fixing Amount
of Supersedeas and Appeal Bond. 143

Order to Transmit Original Exhibit. 148

Petition for Appeal. 129

Praecipe for Transcript of Record. 149

Refusal of A. C. Kains to Join in Appeal. 128

Summons and Severance as to A. C. Kains. . . . 126

*In the District Court of the United States, for the
Northern District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,

Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,

Respondent.

CHARLES C. MOORE, F. W. BRADLEY, MAURICE
SCHWEITZER, R. D. ROBBINS,
WALTER S. MARTIN et al.,

Intervenors.

Agreed Statement.

IT IS HEREBY STIPULATED by and between the respective parties to the above-entitled action that the questions presented by the appeal herein can be determined by the appellate court without an examination of all the pleadings and evidence, and that the following is an agreed statement of the case, showing how the said questions arose and were decided by the District Court, and that this statement sets forth the facts alleged and proved, or sought to be proved, in so far as they may be essential to a decision of such questions by the Circuit Court of Appeals, and shall supersede, for the purposes of this appeal, all parts of the record other than the decree from which the appeal herein is taken. The said agreed statement of the case is as follows: [1*]

*Page-number appearing at foot of page of original certified Record.

On December 6, 1909, Ocean Shore Railway Company, a California corporation, owned and was operating a line of railroad from San Francisco to Tunitas Glen in San Mateo County, a distance of approximately thirty-eight (38) miles, and also a line of railroad from the city of Santa Cruz, northerly about sixteen (16) miles.

On November 1, 1905, Ocean Shore Railway Company made, executed and delivered to Mercantile Trust Company of San Francisco its deed of trust, under and by virtue of the provisions of which Ocean Shore Railway Company granted and conveyed to Mercantile Trust Company of San Francisco, its successors and assigns forever, all properties then owned and thereafter to be constructed or acquired by said railway company, together with all issues, rents, earnings and profits of said railway company, and all franchises, rights of way, leases, licenses, consents, easements, rights, privileges and immunities relating to or appertaining to said railroad or railroad lines and premises and any and all extensions thereof, and all replacements or renewals thereof, and all property and estate which said Ocean Shore Railway Company was then possessed of or entitled to, or which it should thereafter become possessed of or entitled to, and also all other property, whether real, personal or mixed, belonging to said railway company, including all that property which the railway company should thereafter acquire, as well as that which it owned at the date of the execution of said mortgage or deed of trust, it being the intention of said railway company to grant, transfer and con-

vey to said Mercantile Trust Company of San Francisco, as such trustee, all the corporate property and franchises then belonging to said railway company, and also all such corporate property and [2] franchises as it might thereafter acquire. The said deed of trust was duly executed and acknowledged, both as a conveyance of real property and of personal property, in the City and County of San Francisco and in the County of Santa Cruz and in the County of San Mateo.

The said properties were granted and conveyed upon certain uses and trusts set forth in said deed of trust, and, particularly, for the purpose of securing the payment of five thousand (5,000) bonds therein provided to be issued by said Ocean Shore Railway Company, to be certified by said Mercantile Trust Company of San Francisco, of the denomination of one thousand (1,000) dollars each, together with interest thereon at the rate of five (5) per cent per annum, and for the equal and proportionate benefit and security of all holders of said bonds and coupons issued and to be issued under and secured by said deed of trust, and for the enforcement of the payment of said bonds and coupons, when payable, according to their tenor and effect, and to secure the conformance to and compliance with the said deed of trust, without preference, priority or distinction as to lien, or otherwise, of one bond over any other bond, by reason of priority of its issue, sale or negotiation.

Thereafter, upon the request of Ocean Shore Railway Company, Mercantile Trust Company of San

Francisco did certify and deliver to Ocean Shore Railway Company said five thousand (5,000) bonds of the denomination of one thousand (1,000) dollars each, and bearing interest at the rate of five (5) per cent per annum. All of said bonds, except bonds of the par value of four thousand five hundred (4,500) dollars, were issued and became outstanding and unredeemed obligations of [3] said Ocean Shore Railway Company prior to December 6, 1909. By the provisions of said deed of trust, Ocean Shore Railway Company covenanted and agreed duly and punctually to pay the principal and interest of said bonds at the times and places and in the manner mentioned in said bonds and coupons thereto attached. Ocean Shore Railway Company did not pay the said interest due upon said bonds according to the terms thereof, but failed, neglected and refused to pay the interest which fell due on said bonds on the 1st day of November, 1909, and on the 1st day of May, 1910, and no payment of interest was ever made to Mercantile Trust Company of San Francisco, as such trustee, or to anyone else.

It was provided in and by said deed of trust that, in the event of a default in the payment of the interest due upon said bonds, and in case such default should continue for a period of ninety (90) days after written notice thereof from said trustee, the trustee might, and upon the written request of a majority of the bonds secured by said deed of trust should, by a notice in writing, declare the principal of said bonds outstanding to be forthwith due and payable. It was further provided that, in the event

of such default, the said trustee might, at its option, sell to the highest bidder all such property conveyed to it by said deed of trust as such trustee, said Ocean Shore Railway Company covenanting that it would join in any deed of conveyance or other writing evidencing such sale.

“ARTICLE 6. In case the Railway Company shall make default whereby the security hereby created shall become enforceable, the Trustee may, and upon the request in writing of the holders of a majority of the bonds then outstanding, with or without entry, either personally or by its agent or attorney, sell to the highest bidder, in one lot or in parcels, all and singular the trust property and all right, title and interest therein and thereto, which sale shall be at public auction in the City and County of San Francisco, State of California, or at such other place and at such time [4] and upon such terms as the Trustee may fix; but this power of sale shall be exercised only so far as may be authorized by law. In case such power of sale be so exercised, the Railway Company shall join in any deed of conveyance or other writing evidencing such sale.

“ARTICLE 8. Notice of any sale, whether under the power of sale herein contained or in pursuance of an order or decree of court, stating the time when and the place where the same is to be made, containing a brief general description of the property to be sold, shall be published once a week for four successive weeks, prior to such sale, in a newspaper published in the City and County of San Francisco, State of California; and such notice shall also comply with

any requirement of statute of the State of California, or rule or order of court. The Trustee may adjourn any such sale, or cause the same to be adjourned from time to time, by announcement at the time and place appointed for such sale or for such adjourned sale or sales; and without further notice or publication, such sale may be made at the time and place to which the same shall be so adjourned.

“Any such sale or sales made under or by virtue of this indenture, either under the power of attorney hereby granted and conferred, or by virtue of judicial proceedings, shall divest all right, title, interest, estate, claim and demand whatsoever, either at law or in equity, of the Railway Company of, in and to the property sold, and shall be a perpetual bar, both in law and in equity, against the Railway Company, its successors and assigns, and against any and all persons claiming or to claim the property sold, or any part thereof, from, through or under the Railway Company, its successors or assigns.”

On the 12th day of May, 1910, Mercantile Trust Company of San Francisco, under the terms of said deed of trust, by written notice to said Ocean Shore Railway Company, did declare both the principal and interest of said bonds to be forthwith due and payable. Thereafter, and on the 7th day of June, 1910, said Mercantile Trust Company of San Francisco, as such trustee under said deed of trust, for the purpose of rendering effective the provisions thereof and of realizing from the properties covered thereby the bonded indebtedness thereby secured, did duly cause a notice of trustee's sale to be published as re-

quired by the provisions of said deed of trust and fixed the time for such sale as September 1, 1910. Such sale was, on September 1, 1910, duly adjourned and postponed to October 1, 1910, and was finally made as hereinafter set forth.

On December 6, 1909, in the above-entitled court and cause, a bill of complaint was filed by Baldwin Locomotive Works, a corporation of the State of Pennsylvania, against [5] said Ocean Shore Railway Company, there being no other parties to said bill of complaint.

The bill alleged the indebtedness of the Railway Company to complainant on certain past-due promissory notes, an unsecured indebtedness to other creditors in a sum amounting to over \$1,900,000, and the fact that the suit was commenced in behalf of complainant and all other outstanding creditors of the Railway Company who might desire to join in the suit and become parties thereto. The insolvency of the Railway Company was set forth; the danger that the various unsecured creditors might levy execution upon properties of the Railway Company to the great disadvantage of that company and its creditors; the danger that a multiplicity of suits might ensue if such action should be taken, together with the fact that the bonded indebtedness of said corporation above referred to, secured by the said deed of trust in the sum of five million (5,000,000) dollars and covering all the properties which the Railway Company owned, or to which it might subsequently become entitled had, on November 1, 1905, been created, were also alleged.

The Court was asked to appoint a receiver to take possession of and operate the properties of the Railway Company, and for an order directing the receiver to pay, out of moneys coming into his hands, the expenses of operation and the amount of complainant's debt, and other claims which the Court might direct to be paid.

The respondent corporation on the same day filed its answer admitting all the allegations of the bill, joining in its prayer, and F. S. Stratton was thereupon by the Court appointed receiver of said Railway Company and its properties. Said receiver [6] thereupon took possession of and operated the properties of said Ocean Shore Railway Company until February 1, 1911.

A supplemental bill of complaint was filed by the plaintiff in the above-entitled action on May 21, 1910, substantially repeating the allegations of the original bill, and bringing in as a party defendant Mercantile Trust Company of San Francisco, a corporation, the trustee under the deed of trust securing the bond issue of Ocean Shore Railway Company above referred to, together with a number of intervening bond holders, stockholders and creditors who had theretofore filed petitions in intervention, and there was filed with and as a part of said supplemental bill of complaint, and as a written consent to the filing of said supplemental bill, an admission that its allegations were true, signed by the solicitors for the Railway Company.

On July 22, 1910, the said receiver, F. S. Stratton filed a petition in said cause alleging that the prop-

erties and railroad of Ocean Shore Railway Company could not in the future be made to pay the expenses of operation by him, and for this and other reasons praying that the said property and railroad be sold; that Mercantile Trust Company of San Francisco had published the notice above referred to and intended to sell the said properties pursuant to the provisions of the said deed of trust.

On the filing of that petition an order to show cause why said sale should not be made by said receiver in accordance with the prayer of said petition was issued and served upon Mercantile Trust Company of San Francisco, as well as upon the parties of record in the proceeding. In response [7] to the citation and order to show cause, Mercantile Trust Company of San Francisco, by Messrs. Morrison and Brobeck, its attorneys, filed what is designated as a "Special appearance and return of Mercantile Trust Company of San Francisco to order to show cause heretofore issued in the above-entitled proceeding on the 20th day of July, 1910, at the instance and on the petition of F. S. Stratton, claiming to be the duly appointed, qualified and acting receiver of defendant."

In the so-called "Special Appearance and Return," said Mercantile Trust Company of San Francisco prayed that said order to show cause be discharged and the petition of the said receiver denied in so far as the same would interfere with or prevent the action of Mercantile Trust Company of San Francisco in proceeding with the sale and disposition of said properties, under and in accordance with the provi-

sions of said deed of trust, as noticed in the notice of trustee's sale hereinbefore referred to, and that the Court make its order consenting to and permitting Mercantile Trust Company of San Francisco to proceed in the exercise of the powers and authorities conferred upon it by the terms and conditions of said deed of trust for the sale and disposition of the properties of Ocean Shore Railway Company and the application of the proceeds of such sale to the liquidation and satisfaction of said bonded indebtedness. The so-called "Special Appearance and Return" above referred to was filed on July 29, 1910.

The said application of said receiver was heard by the Circuit Court on various dates in August and September, 1910.

At these hearings the attorneys for Mercantile Trust [8] Company of San Francisco, as well as the attorneys for certain of the bondholders of Ocean Shore Railway Company, were present.

On July 28, 1910, after counsel for the Receiver had read from the petition for the sale of said properties, the following dialogue took place:

"Mr. KAUFMAN.—This is the petition which is before the Court. I understand that the Mercantile Trust Company has an answer ready to present this morning.

* * * * *

Mr. BROBECK.—Before counsel proceeds with his testimony, if the Court please, it is perhaps appropriate that the Mercantile Trust Company should file its return to that order to show cause. The form of the return sets up the existence of the bond issue

* * * that the trustee is now proceeding to the sale of the property under the power contained in the deed of trust.

The COURT.—Instead of by the Receiver?

Mr. BROBECK.—Yes, instead of by the Receiver. In coming in and asking that we be permitted to proceed, as we have initiated proceedings, of course, we appreciate that the Court will be in a position to impose some conditions although we ask that the permission be unconditional. The Receiver is suggesting to the Court certain conditions which he regards as appropriate for the purpose of effecting the sale and accomplishing the submission of the best bids for the entire property. * * *

Mr. McNAB.—I suppose, technically, if your Honor please, I have no part in the proceedings. I simply represent bondholders. The Mercantile Trust Company is the trustee for the bondholders. I would like to make an [9] appearance on behalf of Mr. C. C. Moore, representing two hundred of the bonds, and make a statement calling your Honor's attention to the fact that I think this proceeding is only going to complicate matters very much.

Mr. McNAB.—I would like the right to intervene on behalf of the bondholders.

Mr. McNAB.—Have you any objection to an intervention?

Mr. KAUFMAN.—No.

Mr. McNAB.—Have you, Mr. Brobeck?

Mr. BROBECK.—No objection.

Mr. McNAB.—I would like to have ten days to

intervene and to answer the application.

* * * * *

Mr. McCUTCHEN.—You were suggesting, Mr. Kaufman, that no one responded to your petition. I do not understand that any answer is necessary in order to put the receiver on proof as to the accuracy of these figures.

Mr. DAVIS.—I would suggest, your Honor, that the only reason why these figures have not been controverted by pleading by some of the bondholders is that they are controverted by the pleading of the trustee to the petition of the receiver.

The COURT.—I think everybody will be protected by the issues as developed between the return of the trustee to the petition of the receiver.

Mr. DAVIS.—Especially, with reference to these figures. We feel that we are safe in relying on the proposition, in not filing specific answers ourselves on that point, that we will be at liberty fully to question and cross-examine upon the pleading already filed in that regard. [10]

Mr. BROBECK.—The return denies, on information and belief, the accuracy of the figures, and puts them in issue. * * *

Mr. BROBECK.—The testimony proceeds upon the theory that the Court will confine possible preference to operating and maintenance accounts, and possibly to rentals, and that those preferences have been incurred within a period of six months previous to the receivership.

The COURT.—While not the uniform period allowed for in proceedings of this kind, yet it is per-

haps more usual than any other. In some instances, under special circumstances, obligations incurred back of that date have been permitted. Sometimes the circumstances are such that the Court has confined it to a less period. * * *

Mr. EHRMAN.—I understand there will be a ground of preference for furnishing material and other matters which went to the making of the road—labor and services—that all these matters will be enabled to be presented before any order of the Court is made.

Mr. BROBECK.—I suggest that we are in that hearing now.

The COURT.—The Court will hear the whole matter before determining.

Mr. EHRMAN.—The time has not passed for the presentation of claims—am I correct about that?

Mr. BROBECK.—That is correct, Mr. Ehrman. I understand the Receiver is now attempting to ascertain by approximation the amount of possible preferences against this property, so that in the event of this sale any prospective bidder may know how much of a preference he has to take care of.

The COURT.—That is the only purpose of this inquiry. It is not for the purpose of ascertaining down to a refinement, [11] for the purpose of payment or anything of that kind, the different amount of claims at this time. It is for the purpose of fixing the approximate amount which shall be covered in the order of sale as the amount which must be set aside to cover preferences.

Mr. EHRMAN.—Each particular claim will have

to be established. That is, each particular claimant will have to establish his claim before your Honor can make any such order.

* * * * *

Mr. BROBECK.—We anticipate that it will be necessary to insert a new advertisement entirely, and we are keeping alive the present advertisement.

The COURT.—The period of publication is 30 days, is it not?

Mr. BROBECK.—Yes, your Honor, four weeks. We anticipate that when your Honor imposes such conditions as you regard as reasonable, we will have to insert a new advertisement, and begin the advertisement all over.

* * * * *

Mr. BROBECK.—I would like, with permission of everyone, to have considered in evidence the deed of trust securing the issuance of these bonds, etc.

* * *

Mr. BROBECK.—I would ask permission, also, to prepare something of a form of order in the interim, along the lines on which the Receiver has been proceeding.

The COURT.—How do you mean?

Mr. BROBECK.—A possible suggestion of form of order which the Court shall adopt in this matter if it reaches a certain conclusion.”

Further proceedings were had in this matter on September 6, 1910. Another hearing was held on Monday, September 12, [12] 1910. It appears that during said hearings Mr. Brobeck was questioned by Mr. Kaufman as follows:

Mr. KAUFMAN.—So that no active steps had been taken by the Mercantile Trust Company to enforce the lien at the time of the appointment of the Receiver?

Mr. BROBECK.—None had been taken. * * *

Mr. Kaufman then questioned Mr. Brobeck as follows:

Mr. KAUFMAN.—The petition of the receiver was prepared by me, was it not?

Mr. BROBECK.—Yes, certainly it was.

Mr. KAUFMAN.—And the proposed scheme of sale by which all parties might be protected and yet a speedy sale be had was proposed by me, was it not?

Mr. BROBECK.—Well, I think that came out in consultation with you and Mr. McCutchen and myself.

Mr. KAUFMAN.—But I prepared the petition.

Mr. BROBECK.—You prepared the petition in accordance with the suggestions made then, yes.

Mr. KAUFMAN.—As a matter of fact, were not the suggestions all mine, Mr. Brobeck? Was not the scheme mine?

Mr. BROBECK.—I could not truthfully say that, Mr. Kaufman, although I would be very pleased to say so if it were true.

Mr. KAUFMAN.—Your impression is that it was the other way?

Mr. BROBECK.—My impression is that you made the suggestions with others."

At page 163 of the Transcript, the following questions by the Court appears:

"The COURT.—Counsel means that you (Mr.

Brobeck) will not be interested in your capacity as the legal representative of the trustee in the determination by the master or by the Court of the question of priorities. [13]

Mr. BROBECK.—I think I will, I would be very happy to be relieved of that.

The COURT.—How will you be interested in that?

Mr. BROBECK.—It will be necessary for the trustee in the case of any prior liens being created over the bonds, to resist the assertion of any preference up to the time of the sale and the consummation of the sale.”

It was made to appear that all papers in the cause above entitled were served on Mercantile Trust Company of San Francisco and were submitted to Mr. Brobeck as its attorney.

On September 10, 1910, the following proceedings took place:

“Mr. BROBECK.— We can proceed to a sale, but we cannot get any bids.”

During the same session it appears that Mr. McCutchen, representing certain owners of bonds of Ocean Shore Railway Company, participated in the proceedings, at one point saying:

“In the interest of a large number of stockholders, I would like to suggest that we will not have any more information on the 13th of September than we have now.”

At a further hearing of the matter on Tuesday, September 13, 1910, as shown in the Transcript, Mr. Brobeck said:

“I want to make one more suggestion, and that is

with reference to the fixing of an upset price.”

At a further hearing of the matter on September 14, 1910, Mr. McNab, on behalf of C. C. Moore and certain bondholders of Ocean Shore Railway Company, participated in the proceedings and insisted, on behalf of the bondholders, on being heard before the Court took any action in the matter of the various fees to be allowed in the Ocean Shore matter. Mr. Brobeck, during the course of the argument, said: [14]

“Perhaps I was not understood yesterday in response to your Honor’s question in that matter. As I understand it, those claims which are determined to be preferred are themselves entitled to an equitable lien upon these properties. The properties are going to be sold subject to that equitable lien. The Court estimates, we will assume, that the equities will not exceed \$100,000, and that for the purpose of advising a purchaser that he may expect that there will be no more than that amount imposed by equitable liens. * * *

Mr. BROBECK.—If your Honor please, in connection with these matters, I think the Receiver joins with me in the suggestion that the evidence adduced here would warrant the Court in fixing the amount of possible preferences at \$100,000. * * *

The COURT.—What materiality is there, Mr. Brobeck, so long as an upset price is fixed, in having it fixed so low as you suggest?

Mr. BROBECK.—The reason why we suggested an upset price at all, as I explained to your Honor yesterday, was that we are counsel for all the bond-

holders, and some of them will probably not concur.

* * * It will be necessary for those who do concur to finance the disposition of the bonds of those who do not concur. * * *

Now, I think everyone agrees that it is to the best interests of the bondholders that they should unite and purchase this property; in fact, the courts have gone so far as to recognize that commercial possibility and necessity and to endorse some reorganization schemes which have been presented to the Court for the purpose of enabling bondholders to avail themselves of the opportunity to bid and to use their bonds in bidding.

* * *

Mr. BROBECK.—The manner of procedure under which we are now advancing has not contemplated the confirmation of the sale. [15] We are attempting now to secure the permission of the Court to permit the Trustee to proceed to the sale of the property under the power contained in the deed of trust.

The COURT.—Whether it contemplated formal confirmation of the sale, or not, nevertheless this proceeding and all those interested in it, including the trustee, are within the jurisdiction of the Court, and I do not think the Court would be called upon to permit anything unconscionable to be done. * * *

I appreciate all that is said on both sides with reference to this question of upset price. My own conception is that it is not one which eventually forecloses the Court from correcting any error that might appear to have been made in that respect. If it should appear that inequity has been done by the action of the Court in fixing a nominal figure, that

is, of course, subject to correction, or else I am under a very decided misapprehension as to the rights of the Court in a proceeding of this character and although it may be sold by the Trustee under the power nominally of the deed, it nevertheless is sold under the authority and direction of this Court, because the Trustee is now a party to this proceeding and is subject to the jurisdiction of the Court. * * *

Mr. BROBECK.—We will prepare the decree and submit it.”

An order of sale of the said property was made by the Court in pursuance of the foregoing proceedings on September 17, 1910, a copy of which is annexed hereto, made a part hereof, and marked Exhibit “D.” This order was, at the instance of Mercantile Trust Company of San Francisco and other parties, twice amended, the amendment providing, in each case, that the date of sale should be postponed. The notice of sale, under which the property was sold, was published and designated as [16] “Notice of the Trustee Sale of the Properties of Ocean Shore Railway Company, under Permission of the Circuit Court of the United States, etc.”

On January 17, 1911, the properties of Ocean Shore Railway Company were sold by Mercantile Trust Company of San Francisco to Charles C. Moore, F. W. Bradley, R. D. Robbins, Maurice Schweitzer and A. C. Kains, for the sum of \$1,035,000. The sale, as made, was reported back to the Court by Mercantile Trust Company of San Francisco for confirmation. The petition and return of sale prayed for confirmation by the Circuit Court of the

sale reported. It is shown in this petition that the sale was made under the powers created by the trust deed and under the permission of the Circuit Court; that \$166,433.59 was deposited with Mercantile Trust Company of San Francisco, as required by the order of sale as made and amended during the months of September, October and November. It appeared from said petition that, of the sum deposited, Mercantile Trust Company of San Francisco used a portion thereof to discharge the obligations incurred by it in the administration of the trust and the consummation of the sale. It also appeared that, of said sum of \$166,433.59, certain sums had been retained by Mercantile Trust Company of San Francisco in accordance with the order of the Court, which sums were to be paid only in satisfaction of final judgments directing the payment thereof. The petition prayed that the Receiver be directed to join with Mercantile Trust Company in the execution and delivery of the instruments of conveyance.

On the filing of this return by Mercantile Trust Company of San Francisco, an order to show cause was issued and served upon the various parties in interest for the purpose of securing [17] confirmation of the sale. That order recited that Mercantile Trust Company of San Francisco had filed its verified report and petition praying that the sale hereinbefore referred to, made in accordance with the provisions of said deed of trust, and the order of the above-entitled court duly given and made, be confirmed, and then proceeded to direct the Receiver and other parties who had appeared in said action

to show cause, if any there was, why said petition should not be granted.

On August 5, 1910, C. C. Moore requested leave to intervene in the above-entitled action on the ground that he was the owner of bonds of Ocean Shore Railway Company, and that said petition was granted, and that, from that time to the present, the said C. C. Moore has been a party to said action.

Upon the petition of said Moore, the sale of the said properties originally set for September 17, 1910, was, on November 9, 1910, postponed to January 17, 1911.

The sale hereinabove referred to was, by the District Court of the United States, confirmed on the 31st day of January, 1911, on which date the Mercantile Trust Company of San Francisco made, executed and delivered, in its own behalf and as attorney in fact for Ocean Shore Railway Company, its deed conveying all its right, title and interest in and to the properties described in said deed of trust to the said purchaser, F. S. Stratton, as Receiver of Ocean Shore Railway Company, also executed and delivered to the said purchasers a conveyance of all his rights in and to said properties. [18]

On May 12, 1911, A. C. Kains, one of the purchasers above-named, conveyed all his interest in the said properties to Walter S. Martin, intervenor herein.

On May 8, 1911, C. C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin filed their petition in the above-entitled court setting forth the fact that they had purchased the properties of Ocean Shore Railway Company under

the terms of and pursuant to the order of September 17, 1910, alleging their interest in the properties of that company, asking that they be allowed, for their protection to intervene in the above-entitled action and to take such proceedings as they should deem necessary for their protection, and requesting that due notice of all proceedings in the said cause be served upon them. After due hearing, said petition was, on May 15, 1911, granted by the above-entitled court, and, since the making of the said order, the said C. C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin have been and remained parties to the above-entitled action.

On the petition of the Receiver, and prior to the sale above referred to, the Court made four orders of reference to Hon. H. M. Wright, formerly Standing Master in Chancery of the United States Circuit Court for the Ninth Judicial Circuit, Northern District of California, and now Standing Master in Chancery of the above-entitled Court, with respect to debts of said Ocean Shore Railway Company [19] accruing prior to the appointment of said Receiver, said orders being dated, respectively, July 28, 1910, September 29, 1910, March 13, 1911, and June 27, 1911.

The order of July 28, 1910, was made upon the petition of the Receiver filed June 18, 1910, and provided that the Master should determine and report to the Court the relative priorities of the various debts of Ocean Shore Railway Company as against the lien created by the bond issue of said Ocean Shore Railway Company, and particularly the rela-

tive priorities as between the creditors of that company and Mercantile Trust Company of San Francisco, the Trustee named under the said deed of trust referred to, and that the Master should determine what claims of creditors, if any, were entitled to a payment and lien upon properties of Ocean Shore Railway Company prior to and ahead of Mercantile Trust Company of San Francisco.

The order of September 29, 1910, was made at the request of Spring Valley Water Company, which had filed two petitions in intervention relating to debts of the pre-receivership period, and provided that the said Master should determine and report the relative priority as between the debts claimed to be due to Spring Valley Water Company and the bonded indebtedness to Mercantile Trust Company of San Francisco, and that the Master should also determine whether the said Spring Valley Water Company was entitled to payment of the said claims before the Trustee above named, and to a lien upon the properties of Ocean Shore Railway Company prior to and ahead of that of Mercantile Trust Company of San Francisco.

On March 13, 1911, the Court ordered that the question as to the payment of certain debts incurred before the appointment [20] of the Receiver herein, all of which indebtedness consisted of unpaid rentals for lands held and used by Ocean Shore Railway Company under lease, and the payment of which had been ordered by the Court as necessary to the maintenance and operation of the properties, should be referred to the Master for his determination as to

whether or not said indebtedness should be paid before the claim of Mercantile Trust Company of San Francisco and was entitled to a prior and first lien upon properties of Ocean Shore Railway Company to secure such payment.

On June 27, 1911, the Court also ordered that a certain petition in intervention in behalf of certain labor claimants who had rendered services to the Railway Company prior to the appointment of the Receiver, and who had not previously presented their claims to the Master within the time allowed by him, should be referred to and heard by him, and that he should determine whether said claims should be paid before the claim of Mercantile Trust Company of San Francisco, and were entitled to a first and prior lien upon properties of Ocean Shore Railway Company to secure such payment.

Immediately upon the making of the order of July 28, 1910, the Master took steps by formal written notice and publication, according to the order of the Court, to notify the parties interested in the reference of the time and place of hearing. The same course was followed in the other references which were later ordered as shown above, and all persons having claims against said Ocean Shore Railway Company and all persons interested in said reference had due notice of the time and place of hearing thereon.

The hearings were commenced on September 13, 1910, were continued until September 15, 1911, in accordance with the [21] usual equity practice, and various parties interested in the four references

duly appeared either by their solicitors or in person. The necessary pleadings setting forth the grounds relied upon for preference were filed by each of the parties to said proceedings, and answered by a formal pleading of the Trustee, or by the purchasers, the successors in interest of the said Trustee, denying that said claimants, or any of them, were entitled to a prior lien upon properties of Ocean Shore Railway Company to secure the payment of their said claims.

There was sufficient evidence to establish (and there was no evidence to the contrary introduced) that the persons whose names appear in column 1 of Exhibit "A," attached hereto and made a part hereof, performed, between June 1, 1909, and December 6, 1909, in the current ordinary and normal operation of the properties and railroad of said Ocean Shore Railway Company, under contracts between said persons and Ocean Shore Railway Company, services which would have entitled the said persons to the payment of the amounts set opposite their respective names in column 2 of said exhibit. The reasonable value of the services thus rendered was the same as that provided for in the said agreements. The amounts due to the said persons constituted current and ordinary debts of Ocean Shore Railway Company incurred in its normal operation were such debts as would ordinarily have been paid out of the current income from such operation, and the payments of said amounts were not secured by a lien of any character upon the properties of Ocean Shore Railway Company, or by other security.

There was sufficient evidence to establish (and

there was no evidence to the contrary introduced) that the individuals, [22] corporations and copartnerships whose names appear in column 1 of Exhibit "B," attached hereto and made a part hereof, furnished to said Ocean Shore Railway Company materials which were used by it between June 1, 1909, and December 6, 1909, in the current, ordinary and normal operation of its said railroad, under contracts between said individuals, corporations and copartnerships and Ocean Shore Railway Company, either express or implied, which would have entitled the said individuals, corporations and copartnerships to the payment of the amounts set opposite their respective names in column 2 of said exhibit. The reasonable value of the materials thus furnished was the same as that provided for in the said agreements. The amounts due to the said individuals, corporations or copartnerships constituted current and ordinary debts of Ocean Shore Railway Company incurred in its normal operation were such debts as would ordinarily have been paid out of the current income from such operation, and the payments of said amounts were not secured by a lien of any character upon properties of Ocean Shore Railway Company, or by any other lien. No orders for the payment of said claims set forth in Exhibits "A" and "B" were ever made by the said District Court except those contained in the decree of July 18, 1913, and F. S. Stratton, as Receiver of Ocean Shore Railway Company, did not at any time agree to pay said claims, or any thereof.

The labor, materials and supplies for which prior-

ities have been allowed by the findings and report of the Master and by the decree of the District Court were, in each instance, necessary to the business of the Ocean Shore Railway Company as a carrier of freight and passengers, and to the public service, and were absolutely necessary for the maintenance of the railway property and to keep it a going concern.

[23]

The amount set opposite the name of each claimant in the Exhibits showing priorities allowed is, and was at the time the same was furnished or performed, the reasonable value of such supplies or labor, in each instance.

Certain individuals, corporations and copartnerships were the owners of certain property used by Ocean Shore Railway Company in the conduct of its business prior to the appointment of the Receiver herein. After the appointment of the Receiver on December 6, 1909, these individuals, corporations and copartnerships demanded from the said receiver the payment of the amounts due for the use of said properties or the return to them of said properties. The said Receiver thereupon applied to the above-entitled court for authority to issue notes covering the amounts claimed by the said claimants for the use of the properties prior to December 6, 1909, and which said amounts had not been paid. The Court thereupon made its order that the Receiver should issue the said notes, and that said notes should bear interest at the rate of seven per cent per annum. The said notes were actually executed and delivered by said Receiver to all said individuals, corporations

and copartnerships, except to Michael Clark, named in Exhibit "C" hereinafter referred to. The names of the said individuals, corporations and copartnerships to whom the said notes were given, and to whom said amounts were due, are shown in column 1 of Exhibit "C," attached hereto and made a part hereof, and the amounts allowed as preferred claims by the said Master and by the said decree of the District Court given and made on July 18, 1913, are shown in column 2 of said Exhibit "C." The reasonable value of the use of said properties by Ocean Shore Railway Company for the time said properties were used preceding December 6, 1909, and the amount of the notes given by the said [24] receiver to the said individuals, corporations and copartnerships, respectively, and those shown in column 2 of said Exhibit "C" set opposite the name of each individual, corporation and copartnership. There were no funds in the treasury of Ocean Shore Railway Company on December 6, 1909. During the said receivership from December 6, 1909, to February 1, 1911, the receipts from the operation of the properties by the receiver, as shown on the books of the receiver, exceeded the disbursements made for the payment of operating expenses during the same period by the receiver by the sum of \$7,500, but, on the books of the receiver, rentals paid for the use of freight and passenger cars, and for the use of real property, and fees paid to the receiver and to his attorney, and accrued taxes, were not included as costs of operation. The amount paid for the rental of real property, necessary and essential to the opera-

tion of the road and actually used by the receiver during the said period, alone exceeded \$7,500. The amount paid for the rental of passenger and freight cars, such cars being necessary and essential to the operation of the road, was \$6,084.00; the amount paid to the receiver and his counsel exceeded \$7,500.00; the taxes which accrued and were paid by the receiver during the said period were \$2,462.00. Ocean Shore Railway Company earned during the period between June 1, 1909, and December 6, 1909, \$151,000 in the normal, customary and ordinary operation of said railroad. Of the said sum of \$151,000, \$78,500 was used in paying the current and ordinary debts of normal and customary operation, which accrued between June 1, 1909, and December 6, 1909; and the sum of \$42,500 was used in paying the current and ordinary debts of [25] normal and customary operation which accrued during the period prior to June 1, 1909. The balance of said sum of \$151,000, to wit: \$30,000, was devoted to paying expenses other than those accrued in the normal and ordinary operation of said railroad; that is, for expenses of construction, interest on construction charges, rentals for land used by said company, and in extinguishment of car trust obligations, and constituted what has been commonly termed a diversion of current income of Ocean Shore Railway Company earned by it during the period from June 1, 1909, to December 6, 1909, to the extent of that amount. The claimants, however, claimed, both before the Master and before the District Court, upon proper exceptions to the Master's report, that the sums of \$42,500

and \$7500, above mentioned, should be added to the sum of \$30,000, in order to determine the amount of diversion.

There was no evidence introduced as to the time at which said diversion, or any part thereof, occurred, except that the same occurred between June 1, 1909 and December 6, 1909, nor [26] was any evidence introduced to show that such diversion took place after any of the claims referred to in Exhibits "A" and "B" accrued or became payable.

From the commencement of the proceedings before the said Master to the date of sale, Mercantile Trust Company of San Francisco opposed in the said proceedings the allowance of priorities to the said claimants whose names appear on Exhibits "A," "B" and "C," attached hereto, and immediately following the said sale the said purchasers were substituted in the proceedings before the said Master in Chancery for the said Trustee and opposed the said allowance of priorities.

On April 24, 1912, the District Court of the United States, for the Northern District of California, Second Division, made its order allowing, out of funds available for payment of preferred claim creditors, if any, the sum of eight hundred and fifty (850) dollars to John F. Forbes, a certified public accountant who appeared as a witness in behalf of claimants and furnished the evidence upon which a calculation of the amount of diverted income was made by the Master. By this order, the Master was directed to deduct from the amounts allowed preferred creditors, pro rata, the aggregate sum of eight hundred and

fifty (850) dollars, which deduction was made by the Court in its decree given and made on July 16, 1913. Such allowance and deduction was made in the report of said Master.

At the conclusion of the said hearings, on all four orders of reference, the Master prepared his draft report and notified the respective parties that said draft report had been prepared and that objections thereto might be filed. Numerous objections were filed by the various claimants, and said intervenors, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins [27] and Walter S. Martin objected to said report on the ground that, since the Trustee had not sought or obtained the appointment of F. S. Stratton as Receiver, and had not invoked the aid of a court of equity the lien of the trust deed upon the said properties could not be postponed in favor of general unsecured creditors of Ocean Shore Railway Company, and that, if a diversion of current earnings of Ocean Shore Railway Company was shown, no creditor was entitled to priority of lien unless such diversion occurred subsequent to the time at which Ocean Shore Railway Company became indebted to him, and that there was no evidence as to the time when a diversion, if any there was, took place. These objections were overruled by the said Master who, thereupon, made his report on all references to the above-entitled court, in which he determined that the claimants whose names appear on Exhibit "A," attached hereto, were entitled to the payments of the amounts set opposite their respective names in column 3 thereof; that the claim-

ants whose names appear on Exhibit "B," attached hereto, were entitled to the payment of the amounts set opposite their respective names in column 3 of said Exhibit; and that the claimants whose names appear on Exhibit "C," attached hereto, were entitled to the payment of the amounts set opposite their respective names in column 2 of said Exhibit.

The said Master found that the ultimate aggregate of allowances of prior payments to unsecured claimants was limited by the amount of diversion to the benefit of bondholders, except in those cases where the exigencies of the receivership made the allowance of full payment of back debts and the giving of receiver's notes necessary, being those appearing in Exhibit "C"; that the amount of the diversion was thirty thousand [28] (30,000) dollars, and the claimants named in Exhibits "A" and "B" were only entitled to sixty-two (62) per cent of the amount shown in column 1 of said Exhibits "A" and "B" to have been due and owing to them at the time said Receiver was appointed; that each of the claimants whose names appear in column 1 of said Exhibits "A" and "B" was entitled to the payment of the sum set opposite his name in column 3 of said Exhibits, said amount constituting sixty-two (62) per cent of the amount shown in column 2 of said Exhibits, after making the deductions ordered by the District Court to provide for the payment of eight hundred and fifty (850) dollars to the said Forbes; that each of said claimants was also entitled to a first and prior lien upon said properties so purchased by said committee, to secure the payment of said sums

so set forth in column 3 of said Exhibits "A" and "B"; that those persons whose names appear in column 1 of said Exhibit "C" were entitled to the payments of the amounts set forth in column 2 of said exhibit, and to a lien upon said properties to secure the payment of said sums so set forth in said column 2.

Charles C. Moore, F. W. Bradley, Maurice Schweitzer, Walter S. Martin and R. D. Robbins duly filed their exceptions to said report in the above-entitled court on the ground that, since neither the Trustee nor the said individuals, as the successors in interest of said Trustee, had asked for the appointment of a receiver, or taken any steps to secure said appointment, or invoked the assistance of said or any court of equity, their rights in the properties could not be diminished or postponed for the benefit of those in whose favor the Master had found, and, furthermore, that since [29] there was no showing that the diversion found by the Master took place subsequent to the time at which any particular claimant's right to payment accrued, no priorities could be allowed to any claimants, and various of those claimants whose names appear on Exhibits "A" and "B" filed their objections to said report based upon the ground that the claims of laborers and those who furnished supplies from June 1, 1909, to December 6, 1909, were entitled to payment in full of the amounts set forth in column 3 of each said exhibit opposite the respective name of each said claimant, and, to secure said payment, to a lien upon the properties of Ocean Shore Railway Company

ahead of and prior to that of Mercantile Trust Company of San Francisco, regardless and irrespective of the amount of diversion of current operating income during the said period. Argument was duly had upon said objections and on July 18, 1913, the above-entitled court made its order and decree hereinabove referred to.

A copy of the opinion rendered by the said District Court in the above-entitled action on January 20, 1913, is annexed hereto, made a part hereof, and marked Exhibit "E."

IT IS FURTHER STIPULATED that, in view of the size of the said report of the said Master, and the fact that a large portion thereof is devoted to a discussion of questions the determination of which is not involved on this appeal, said report shall not be printed in the record, but that any party hereto may refer thereto and rely thereon as fully and to the same extent that he could if said report were incorporated herein in full.

I have examined this statement and consider that it fully and fairly states the record herein.

H. M. WRIGHT,
Master in Chancery. [30]
BELLEW & WRIGHT,
S. C. WRIGHT,
Attorneys for E. L. Braswell.
W. C. GRAVES,
Attorney for J. G. James Co.
F. S. WRIGHT and
W. H. SCHULTE,
Attorneys for Chas. H. Wilson.

MARSHALL NUCKOLLS,
Attorney for C. B. Johnson.

O. C. PRATT,
Attorney for Louis Lait.

FRANK M. HULTMAN,
Attorney for Aug. Johnson.

W. W. ALLEN,
Attorney for Dr. A. S. Keenan.

F. J. KIERCE,
Attorney for P. O'Farrell.

RITTENHOUSE & JOHNSTON,
Attorneys for J. F. Giblin.

J. C. CAMPBELL and
DAVID L. LEVY,

Attorneys for Fairbanks, Morse & Company.

WILLIAMSON & DIBBLEE,
Attorneys for W. L. Holman Co.

CUSHING & CUSHING,
Attorneys for Remington Typewriter Company.

CHARLES A. STRONG,
Attorney for Acme Lumber Co.

DONALD HORNE,
Attorney for E. W. Thomas Oil Burner Company.

OLNEY, PRINGLE & MANNON,
Attorneys for Western Building Material Company.

WM. B. BOSLEY,
LEO. H. SUSMAN,

Attorneys for San Francisco Gas & Electric Com-
pany.

J. E. FOULDS,
E. J. FOULDS,

Attorneys for Southern Pacific Company. [31]

GOODFELLOW, EELLS & ORRICK,

Solicitors for Certain Claimants: Dr. J. C. Spencer, E. Moulty, John Hurley, Mary Knights, Colita Chatard, Clara Ferini, W. P. Geary, John Noriega, J. H. Hurlbut, W. J. Berger, Dr. Albert B. McKee, Drs. Phillips & Phillips, Dr. W. A. Brooks or Brooke, Clara Greene, L. C. Greene, Francis M. Sellers, D. H. or E. H. Danmann, A. L. Geggus, J. W. Crosby, J. M. Gilbert, P. P. Chatard, H. V. Rippon, Carl Sager, Metta E. Stross, C. N. Compton, A. S. Lozier, Louis Zachert, Gus D. Hurlbut, Frank L. Sawyer, W. M. Boeken, Mary J. Hanley, E. T. Charlton, Chas. E. Croly, W. N. Frye, Sidney Sprout, Smith Emery Co., F. A. Hihn Co., E. L. Smith, Australian Hardwood Co., California Litho. Co., A. Carlisle & Co., S. F. Call, Dow Pump Eng. Co., Eccles & Smith Co., John Finn Metal Wks., General Electric Co., Gallagher & Motts, Great Western Smelting & Refining Co., Holmes Lime Co., G. M. Josselyn & Co., L. Kingswell, Peck-Judah Co., J. A. Roebling's Sons Co., Squire & Byrne, Enterprise Foundry Co., White Brothers, Pinkerton's Nat'l Detective Agency, Dr. W. C. Hopper, Helen W. Lee, E. S. Reinoehl, Thos. Day Co., Ft. Pitt Spring Mfg. Co., Gould Coupler Co., Joost Bros., Smith Copper Works, Fred Ward & Son, Ernest De Temple, L. & M. Alexander & Co., Santa Cruz Water Wks., Pacific States Electric Co.

MAURICE R. CAREY,

Solicitor for Certain Claimants F. L. Donahoo, L. T. Coates, H. L. Staples, Mrs. J. E. Shilladey, C. E. Bass, J. L. Whissen, H. L. Goodloe, R. J. Ellis, Oliver W. Hall, E. G. Gray, S. K. Woodburn, Fred L. Sparks, O. J. Effenbeek, J. A. Roix, W. N. Silsby, W. D. Wilcox, F. A. Stoekel, Wm. A. Roix, J. Matthews, J. W. Gray, F. H. Sage, Oscar S. Westberg, R. P. Standley, W. B. Scott, H. Horn, C. Becker, George W. Agnew, D. W. Bale, J. W. Carter, C. Conto, L. Lucas or Lukas, F. J. Lyons, John J. Dake, Henry Rosenblad or Rosenblatt, Daniel Keith, M. H. Lawson, John Kennedy, Xavier Pasqualine, C. E. Twisselman, E. B. Shilladey, Fred Helin, D. R. Parsley, S. George, C. E. Wilcox, M. Moeller, S. F. Dart, A. Poulos, John Conto, J. Vorigachis, Charles T. Faucett, Patrick Cavanaugh, James Rosar, A. E. Siebel or Siegel, A. J. Ault, F. J. Bettinger, N. Louto, George Doody, R. H. Shaves, J. Markis, G. & J. Metzger, F. J. Reedy.

[32]

JOHN O. McELROY,

Solicitor for Certain Claimants: Chris Economou or Conomu, Gus Kostakis, F. Legourious (Legoris), N. Spiros, Mike Popovitz, P. Judas, C. Pappas, J. Gergusiakis, P. Drulis, C. Pappas, N. Pappostolu, A. Kiniafatos, P. Nickolas, P. Paulis, J. Paulis, J. Kafolas, P. Miles, P. Kafolas, J. Pandaces, M. Panos, M. Simon.

SULLIVAN & SULLIVAN and
 THEO. J. ROCHE,
 J. F. SULLIVAN,

Solicitors for Certain Claimants: F. G. Barelay, P. Long, Jas. Mills, C. O. Reeves, Michael Albrecht, Thos. E. Hanley, Peter White, Chas. W. Baker, H. P. Thomas, Wm. A. Doyle, I. W. Fleming, L. Welch, T. M. Daly, C. W. Finch, M. S. Kentzell, A. Shilling, Geo. G. Smith, H. H. McEwan, J. L. Cunningham, S. J. Murphy, Charles Butler, D. J. McGowan, Timothy O'Driscoll, M. R. Twomey, John Fitzpatrick, J. W. Manning, Chas. Colson, Wm. Otterson, E. P. Lenox, F. L. Berry, J. S. Grow, A. Engelson, E. L. Duncan, M. E. Hale, Owen Larkin, S. L. Kampschmidt, F. L. Browne, Chas. Jarvis, J. O. Frain, Peter Johnson, M. J. Howe, M. J. McGuire, Thos. J. O'Keefe, Thos. H. Williams, Patrick Galvin, Wm. A. Stoll, Louis Irons, K. O. Whitson, John Kenny, F. J. Bettinger, Thos. Hewitt, Wm. H. Baxter, H. P. Elliott, J. J. Higgins, G. Priola, F. F. Roake, Jas. Casper, H. H. Jordan, F. W. Cassidy, J. H. Murphy.

EDWARD J. McCUTCHEN,
 GAVIN McNAB,
 A. CRAWFORD GREENE,

Solicitors for Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin.

McCUTCHEN, OLNEY & WILLARD,
 Of Counsel. [33]

BARROWS & BARROWS and
W. H. BARROWS,

Solicitors for Gertrude H. Collins.

KNIGHT & HEGGERTY and
CHAS. J. HEGGERTY,

Solicitors for the Estate, Trustee and Distributees
of Cornelius O'Connor, Deceased.

WEINMANN, WOOD & CUNHA,

Attorneys for B. T. Cowgill.

ANDROS & HENGSTLER,
LOUIS T. HENGSTLER,

Attorneys for Simplex Railway Appliance Company.

CARL E. LINDSAY,
per E. T. BARRETT,

SCHLESINGER & SHAW,

Attorneys for S. K. Mitsuse.

R. PORTER ASHE,

Attorney for C. P. Mosconi.

CHARLES A. LEE,

Attorney for S. Skliris.

WILLIAM A. NUNLIST,

Attorney for N. Paris,

R. S. NORMAN,

Attorney for Patrick Moloney.

CULLINAN & HICKEY,

NEAL POWER,

Formerly Attorneys for Administrator of Estate of
Michael Clark, Now Deceased.

GIBSON & WOOLNER and

E. M. GIBSON,

Attorneys for Boyce Lumber Co., E. J. Boyce, Mary
E. Bates.

JOHN E. BEHAN,

Sec. of, for Spring Valley Water Co.

S. D. BESECKER,

L. T. JACKS,

Solicitor for J. Homer Fritch, Inc.

A. G. WILKINS,

Solicitor for T. E. Vanomen. [34]

KIRK & KENNEDY and

J. W. HENDERSON,

Attorneys for Certain Claimants: Coffin Redington & Co., W. P. Fuller & Co., Gorham Rubber Co., Pacific Hdwe. & Steel Co., Schwabacher, Frey Sta. Co., Selby Smelting & Lead Co., Geo. H. Tay Co., A. L. Young Mach. Co., Zellerbach Paper Co.

RICH'D BAYNE,

J. P. LANGHORNE,

Attorneys for Certain Claimants: Postal Telegraph Co., Westinghouse Airbrake Co., Westinghouse Traction Brake Co.

MORRISON & BROBECK,

MORRISON, DUNNE & BROBECK,

Attorneys for Mercantile Trust Company of San Francisco.

W. W. KAUFMAN,

Attorney for F. S. Stratton, Receiver of the Ocean Shore Railway Company.

DANIEL H. KNOX,

Solicitor for Certain Claimants: Knox Collection Agency, Assignee Wm. C. Knox.

REID & DOZIER,

Solicitors for Chas. A. Warren Co., Thomas B. Dozier.

[Order Approving and Allowing Agreed Statement.]

The foregoing statement is hereby approved and allowed as correct.

December 16th, 1913.

WM. C. VAN FLEET,
Dist. Judge. [35]

**Exhibit "A" [to Agreed Statement—List of Claims,
etc.].**

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
Dr. J. C. Spencer.....	\$157.50	\$ 94.50	\$154.74
E. Moulty.....	80.11	48.06	78.71
F. G. Barclay.....	59.18	35.46	58.14
Charles Butler.....	159.70	95.82	156.90
M. J. Howe.....	114.41	68.64	112.40
P. Long.....	374.46	224.64	367.90
D. J. McGowan.....	147.52	88.50	144.94
M. J. McGuire.....	393.27	235.92	386.38
James Mills.....	96.36	57.76	94.67
Timothy, O'Driscoll.....	110.30	66.18	108.37
Thos. J. O'Keefe.....	148.70	89.22	146.09
C. O. Reeves.....	208.35	124.98	204.70
M. R. Twomey.....	268.97	161.34	264.26
Thomas H. Williams.....	242.11	145.26	237.87
Michael Albrecht.....	368.87	221.28	362.41
John Fitzpatrick.....	60.87	36.48	59.80
Patrick Galvin.....	258.80	155.28	254.27
Thomas E. Hanley.....	235.75	141.42	231.62
J. W. Manning.....	312.11	187.26	306.65
John Hurley.....	147.41	88.44	144.83
B. T. or B. F. Cowgill..	84.44	50.64	82.96

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
Wm. A. Stoll	\$174.15	\$164.48	\$269.35
Peter White..	290.35	174.18	285.24
Mary Knights....	91.41	54.84	89.81
Colita Chatard.... .	50.61	30.36	49.72
Clara Ferini	26.74	16.02	26.24
W. P. Geary..	322.69	193.56	317.04
[36]			
John Noriega	173.92	104.34	170.87
E. L. Smith....	76.58	45.90	75.24
J. H. Hurlbut..... .	496.87	298.08	488.17
W. J. Berger	349.63	209.76	343.50
Charles Colson..	49.00	29.40	48.14
Dr. Albert B. McKee...	22.00	13.20	21.61
Drs. Phillips and Phillips	124.50	74.70	122.31
Louis Irons..	150.15	90.06	147.52
Chas. W. Baker	637.50	382.50	626.34
Wm. Otterson.... .	202.80	121.68	199.25
K. O. Whitson.. . . .	276.26	165.72	271.50
H. P. Thomas.... .	98.55	59.10	96.82
E. P. Lenox....	55.05	33.00	54.08
Dr. W. A. Brooks or Brooke	12.50	7.50	12.28
Clara Greene	53.84	32.28	52.89
L. C. Greene.... .	186.52	111.90	183.50
Francis M. Sellers.....	299.74	179.82	294.49
D. H. or E. H. Danmann.	44.00	26.40	43.23
A. L. Geggus....	212.03	127.20	208.32
J. W. Crosby....	241.55	144.90	237.32
J. M. Gilbert..... .	82.52	49.50	81.07
P. P. Chatard.... .	81.28	48.72	79.85

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
H. V. Rippin.....	\$ 94.78	\$ 56.82	\$ 93.12
Carl Sager.....	75.92	45.54	74.59
Metta E. Stross.....	83.11	49.85	81.65
C. N. Compton.....	149.85	89.88	147.22
Louis Zachert..	59.58	35.70	58.53
Gus D. Hurlbut.....	199.77	119.82	196.27
[37]			
Frank L. Sawyer.....	168.42	101.04	165.47
F. L. Donahoo.....	210.38	126.18	206.70
L. T. Coates.....	224.12	134.46	220.19
H. L. Staples.....	296.29	177.72	291.10
Mrs. J. E. Shilladey.....	262.79	157.62	258.19
C. E. Bass.....	224.41	134.64	220.48
J. L. Whissen.....	167.93	100.74	164.99
H. L. Goodloe.....	264.62	158.76	259.99
R. J. Ellis.....	119.96	71.94	117.86
Oliver W. Hall.....	88.68	53.16	87.13
E. G. Gray.....	115.84	69.48	113.81
S. K. Woodburn.....	141.90	85.14	139.41
Fred L. Sparks.....	249.29	149.52	245.27
O. J. Effenbeck.....	176.84	106.08	173.74
J. A. Roix.....	272.18	163.26	267.41
W. N. Silsby.....	116.95	70.14	114.90
W. D. Wilcox.....	5.22	3.12	5.13
F. A. Stoekel.....	222.05	133.20	218.16
Wm. A. Roix.....	322.75	193.63	317.10
J. Matthews.....	295.50	177.30	290.33
J. W. Gray.....	53.73	32.22	52.29
F. H. Sage.....	260.95	156.54	256.38
Oscar S. Westberg.....	164.30	98.58	161.42

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
R. P. Standley.....	\$201.30	\$120.78	\$197.77
W. B. Scott.....	198.02	118.80	194.55
H. Horn	184.60	110.76	181.37
C. Becker	478.93	287.34	470.55
George W. Agnew.....	54.89	32.88	53.93
[38]			
D. W. Bale.....	173.84	104.28	170.79
J. W. Carter	14.52	8.70	14.27
C. Conto	267.80	160.68	263.11
L. Lucas or Lukas.....	86.24	51.72	84.73
F. J. Lyons.....	243.29	145.92	239.03
John J. Dake.....	318.63	191.16	313.05
Henry Rosenblad or Rosenblatt	134.86	60.88	132.50
Daniel Keith	138.25	82.92	135.83
W. M. Boeken.....	17.75	10.62	17.44
W. M. Boeken.....	52.50	31.50	51.58
M. H. Lawson.....	112.55	67.50	110.58
John Kennedy.....	18.26	10.92	17.94
Xavier Pasqualine.....	105.25	63.12	103.41
C. E. Twisselman.....	288.75	173.22	283.69
E. B. Shilladey.....	341.12	204.66	335.15
Fred Helin	46.65	27.96	45.83
D. R. Parsley.....	54.55	32.70	53.59
S. George	34.48	20.64	33.87
M. Moeller	15.00	9.00	14.74
E. L. Braswell.....	577.06	346.20	566.96
M. Moeller	10.00	6.00	9.82
M. Moeller	15.00	9.00	14.74
M. Moeller	12.25	7.32	12.03

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
S. F. Dart.....	\$218.58	\$131.10	\$214.75
A. Poulos	121.26	72.72	119.13
John Conto	181.34	108.76	178.16
J. Verigachis	43.52	26.10	42.76
[39]			
Mary J. Hanley.....	112.00	67.20	110.04
E. T. Charlton.....	718.30	430.98	705.73
Charles T. Faucett....	195.92	117.54	192.48
Patrick Cavanaugh	169.12	101.46	166.16
C. E. Wilcox.....	332.05	199.20	326.24
Chris Economou or Conomu	104.19	62.46	102.36
Gus Kostakis	120.09	72.00	117.99
F. Legourious	40.00	24.00	39.30
N. Spiros	51.94	31.16	51.03
Mike Popovitz	10.55	6.33	10.36
P. Judas	10.55	6.33	10.36
C. Pappas	13.10	9.86	12.87
John Kenny	79.89	47.93	78.49
Chas. E. Croly	107.10	64.26	105.22
J. G. James Co.....	285.10	171.06	280.11
W. H. Frye	69.50	41.70	68.28
Wm. C. Knox.....	118.30	70.98	116.23
Chas. H. Wilson.....	156.75	94.05	154.00
C. B. Johnson.....	174.27	104.56	171.22
James Rosar	226.25	135.75	222.29
A. E. Siebel or Siegel...	161.52	96.91	158.69
J. Gergusiakis	35.96	21.57	35.33
P. Drulis	76.36	45.82	75.02
Louis Lait	94.50	56.70	92.84

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
T. E. Vanomen.....	\$ 62.00	\$ 37.20	\$ 60.91
Aug. Johnson	37.95	22.77	37.28
C. Pappas	109.95	65.97	108.02
[40]			
Dr. A. S. Keenan.....	25.00	15.00	24.56
P. O'Farrell	29.90	17.94	29.37
J. F. Giblin	226.23	135.74	222.27
D. E. Besecker.....	210.75	126.45	207.06
Sidney Sprout	157.68	94.61	154.92
Knox Collection Agency, assignee	100.00	60.00	98.25
F. O. Rood, assignee....	71.25	42.75	70.00
C. P. Mosconi	163.94	98.36	161.07
J. Miller (assignee)....	202.91	121.74	199.36
S. Skliris	53.70	32.22	52.76
Dr. W. C. Hopper.....	63.50	38.10	62.39
Wm. A. Doyle.....	197.14	118.28	193.69
Helen W. Lee.....	276.04	165.62	271.23
E. S. Reinoehl.....	138.03	82.82	135.61
A. S. Lozier.....	566.55	339.93	556.63
A. J. Ault.....	106.50	63.90	104.63
N. Papostolu	11.05	6.63	10.85
F. L. Berry.....	142.15	85.00	139.66
F. J. Bettinger.....	199.97	119.94	196.47
I. W. Fleming.....	300.69	180.36	295.49
J. S. Grow.....	248.60	149.16	244.25
Thomas Hewitt	79.55	47.70	78.15
L. Welch	219.66	131.76	215.80
A. Engelson	77.57	46.50	76.20
Wm. H. Baxter.....	198.40	119.04	194.92

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
T. M. Daly.....	\$350.59	\$210.35	\$344.49
F. L. or G. L. Duncan...	145.45	87.27	142.90
H. P. Elliott.....	152.95	91.77	150.27
C. W. Finch.....	170.52	102.31	167.53
[41]			
M. E. Hale.....	81.35	48.81	79.92
J. J. Higgins.....	231.56	138.93	227.50
M. S. Kentzell.....	95.61	57.36	93.93
Owen Larkin	41.75	25.05	41.02
G. or J. Priola.....	67.90	40.74	66.71
A. Shilling	25.73	15.43	25.28
Ernest De Temple.....	81.50	48.90	80.07
P. Nickolas	88.60	53.16	87.05
P. Paulis	137.85	82.71	135.43
J. Paulis	171.10	102.66	168.10
J. Kafolas	175.60	105.36	172.52
P. Milos	103.60	62.16	101.78
P. Kafolas	28.30	16.98	27.80
J. Pandaces	28.30	16.98	27.80
M. Panos	23.90	14.34	23.48
M. Simon	41.03	24.62	40.31
A. Kiniafatos	55.70	33.42	54.72
N. Paris	144.35	86.61	141.82
S. L. Kampschmidt.....	46.24	27.72	45.43
F. F. Roake	44.90	26.94	44.11
George G. Smith.....	134.37	80.58	132.02
N. Louto	75.04	45.00	73.72
George Doody	153.13	91.86	150.45
R. H. Shaves.....	76.00	45.60	74.67
J. Markis	17.80	10.68	17.49

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
G. or J. Metzger.....	\$ 66.65	\$ 39.96	\$ 65.48
F. J. Reedy.....	135.13	81.06	132.76
[42]			
F. L. Browne	249.90	149.94	245.52
Jas. Casper	128.38	77.03	126.13
H. H. McEwen.....	334.75	200.85	328.89
Charles Jarvis	126.39	75.84	124.18
H. H. Jordan.....	290.35	174.21	285.27
J. L. Cunningham.....	430.40	258.24	422.87
J. O. Frain.....	395.34	237.21	388.42
F. W. Cassidy.....	253.17	151.90	248.74
S. J. Murphy.....	103.26	61.96	101.45
Peter Johnson	216.90	130.14	213.10
J. H. McMurphy.....	308.04	184.82	302.65
S. K. Mitsuse.....	2143.29	1285.97	2105.78
[43]			

Exhibit "B" [to Agreed Statement—List of Claims, etc.].

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
Smith Emery Co.....	\$ 12.00	\$ 7.20	\$ 11.79
Fairbanks, Morse & Co..	261.62	156.97	257.04
J. Homer Fritch, Inc...	344.37	206.62	338.34
W. L. Holman Co.....	97.15	58.29	95.45
Remington Typewriter Co.....	47.23	28.34	46.40
Acme Lumber Co.....	313.82	188.29	308.32
E. W. Thomas Oil Burner Co.....	150.00	90.00	147.37
Western Building Ma- terial Co.....	162.64	97.58	159.79

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
San Francisco Gas and			
Electric Co.	\$2955.31	\$1773.18	\$2903.59
Southern Pacific Co....	566.73	340.04	556.81
Postal Telegraph Cable			
Co.....	178.31	106.98	175.19
Westinghouse Airbrake			
Co.....	361.24	216.74	354.92
Westinghouse Traction			
Brake Co....	617.85	370.71	607.03
Simplex Ry. Appliance			
Co.....	42.00	25.20	41.26
F. A. Hihn Co.....	387.10	232.26	380.32
E. L. Smith.....	20.00	12.00	19.65
Australian Hardwood			
Co.....	36.75	22.05	36.10
California Litho Co....	24.00	14.40	23.58
A. Carlisle & Co.....	1010.40	606.24	992.71
S. F. Call.....	914.64	548.78	898.63
Dow Pump Eng. Co....	150.00	90.00	147.37
[44]			
Eccles & Smith Co....	42.05	25.23	41.31
John Finn Metal Works	130.77	78.46	128.48
General Electric Co....	689.25	413.55	677.19
Gallagher & Motts.....	90.00	54.00	88.42
Great Western Smelting			
& Refining Co.....	94.60	56.76	92.98
Holmes Lime Co.....	26.80	16.08	26.33
G. M. Josselyn & Co....	323.82	194.29	318.15
L. Kingswell	155.53	93.32	152.81
Peck-Judah Co....	10.00	6.00	9.82

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
J. A. Roebling's Sons			
Co.	\$ 73.93	\$ 44.36	\$ 72.63
Squire & Byrne.....	176.13	105.68	173.04
Enterprise Foundry Co.	129.81	77.88	127.54
Pacific States Electric			
Co.....	38.96	23.37	38.28
White Brothers	292.58	175.55	287.46
Pinkerton's Nat'l Detec-			
tive Agency	93.00	55.80	91.37
Thos. Day Co.....	1.50	.90	1.47
Ft. Pitt Spring Mfg. Co.	19.74	11.84	19.39
Gould Coupler Co.....	90.00	54.00	88.42
Joost Bros....	10.15	6.09	9.97
Smith Copper Works...	85.99	51.59	84.48
Fred Ward & Son.....	17.63	10.58	17.32
Coffin, Redington & Co..	2.55	1.53	2.50
W. P. Fuller & Co.....	500.07	300.04	491.32
Gorham Rubber Co....	215.70	129.42	211.92
Pacific Hardware &			
Steel Co.	575.06	345.03	565.00
Schwabacher Frey Sta-			
tionery Co.....	16.00	9.60	15.72
Selby Smelting & Lead			
Co.	1.66	1.00	1.63
[45]			
Geo. H. Tay Co.....	12.12	7.27	11.90
A. L. Young Mach. Co...	10.00	6.00	9.83
Zellerbach Paper Co....	38.18	22.90	37.51
L. & M. Alexander & Co.	3.00	1.80	2.94

Name.	Amt. of Preferred Claim.	Amt. Allowed Priority as Pro Rata.	Amt. to be Paid Under Decree.
Santa Cruz Water Works.....	\$ 3.00	\$ 1.80	\$ 2.94
Spring Valley Water Co.....	1174.96	704.98	1154.40

[46]

Exhibit "C" [to Agreed Statement—List of Persons Entitled to Certain Payments].

Trustees of the estate of C. O'Connor, deceased, with simple interest at seven (7) per cent from April 21, 1910....	\$1298.39
Gertrude H. Collins, with simple interest at seven (7) per cent from January 24, 1910	3277.42
Patrick Moloney, with simple interest at seven (7) per cent from May 31, 1910.	547.65
Boyce Lumber Co., and E. J. Boyce, with simple interest at seven (7) per cent from February 7, 1910.....	14.51
E. J. Boyce, Boyce Lumber Co. and Mary E. Bates, with simple interest at seven (7) per cent from February 7, 1910..	29.03
E. J. Boyce, with simple interest at seven (7) per cent from February 7, 1910..	9.68
Michael Clark, without interest.....	767.10

[47]

**Exhibit "D" [to Agreed Statement—Order
Permitting Sale of Properties].**

IN THE
CIRCUIT COURT
OF THE
UNITED STATES

In and for the Ninth Judicial Circuit, Northern
DISTRICT OF CALIFORNIA.

ORDER PERMITTING SALE OF
PROPERTIES.

OCEAN SHORE RAILWAY COMPANY

October 19, 1910

BALDWIN LOCOMOTIVE WORKS, a Corpora-
tion,

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY, a Cor-
poration,

Defendant. [48]

*In the Circuit Court of the United States, in and
for the Ninth Judicial Circuit, Northern Dis-
trict of California.*

BALDWIN LOCOMOTIVE WORKS (a Corpora-
tion),

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY (a Cor-
poration),

Defendant.

The matter of the Application and Petition of Frederick S. Stratton, for an order directing the immediate sale of all of the properties of the Ocean Shore Railway Company, now held or possessed by him in virtue of that certain order heretofore made and entered in the above-entitled action on the 6th day of December, 1909, appointing said Frederick S. Stratton receiver of the Ocean Shore Railway Company, defendant, coming on regularly to be heard, upon the 25th day of July, 1910, the 19th day of August, 1910, and the 6th, 10th, 12th, 13th and 14th days of September, 1910, upon said application and petition, upon the citation and order to show cause heretofore issued therein, on the 20th day of July, 1910, and also upon the return thereto and cross-petition filed herein on the 25th day of July, 1910, by Mercantile Trust Company of San Francisco, as trustee named in that certain deed of trust heretofore executed by Ocean Shore Railway Company, defendant, on the first day of November, 1905,

wherein said Mercantile Trust Company of San Francisco, as such trustee, requests permission to proceed with the sale of said properties under the authority conferred upon said Mercantile Trust Company of San Francisco by said deed of trust; and oral and documentary evidence having been introduced in support of such respective petitions, and the matter being finally submitted to the court for consideration and decision, and the court having fully considered the same, and being fully advised in the premises, the court now finds: [49]

I.

That heretofore, and prior to the 20th day of July, 1910, said citation and order to show cause and copies of said petition were served upon Baldwin Locomotive Works, plaintiff, Ocean Shore Railway Company, defendant, upon Mercantile Trust Company of San Francisco, trustee, and upon H. D. Pillsbury, Laura L. Sims, Ellenor H. Doe, J. A. Folger, J. Downey Harvey, J. F. Bradford, J. Howard Smith, J. Homer Fritch, a corporation, National Car Line Company, a corporation, American Steel & Wire Company, a corporation, Charles H. Wilson, Nicholas Michelson, R. P. Standley on behalf of himself and fifty-seven (57) other creditors, William H. Baxter on behalf of himself and forty (40) other creditors, and Ralph W. Heins, C. E. Lilly, H. F. Keon and S. A. Palmer, and certain other creditors, interveners, or their solicitors or attorneys of record in said cause, and upon all of the parties to said proceeding, who have appeared or intervened, or are represented by solicitors or attorneys therein.

II.

That no opposition nor objection to the granting of said application and petition of said receiver, other than the return of said Mercantile Trust Company of San Francisco thereto, and of said interveners, C. E. Lilly and Ralph W. Heins, copartners doing business under the firm name of Lilly & Heins, and no opposition nor objection to the granting of the cross-petition of said Mercantile Trust Company of San Francisco, has been filed herein.

III.

That heretofore, to wit, on the first day of November, 1905, the Ocean Shore Railway Company, defendant, did make, execute and deliver to Mercantile Trust Company of San Francisco, its certain deed of trust, under and in virtue of the provisions of which said Ocean Shore Railway Company did grant, bargain, sell, assign, transfer and convey unto said Mercantile Trust Company of San Francisco, its successors and assigns forever, all properties then owned or thereafter to be constructed or acquired by said railway company, together with all rents, issues, tolls, income, earnings and profits of the said Ocean Shore Railway Company, and also all the franchises, rights of way, leases, licenses, consents, easements, and rights, privileges and immunities relating or appertaining to said railroad or railroad lines and branches, and any and all extensions thereof or additions thereto, and all replacements or renewals of the same or any part thereof, and all like property and estate which the said Ocean Shore Railway Company then possessed, owned, or was entitled to, or

should thereafter become possessed of or entitled to, and all the estates, grants, rights, titles, interests, possessions, claims [50] and demands whatsoever, as well in law as in equity, of the said Ocean Shore Railway Company, of, in and to said property and premises in said deed of trust more particularly set forth and defined, and every part and parcel thereof, with the appurtenances thereunto belonging, and any and all bonds and shares of stocks of any other corporation or corporations then owned or at any time thereafter acquired by the said Ocean Shore Railway Company, its successors or assigns, and also all other property, whether real, personal or mixed, belonging to the said Ocean Shore Railway Company, including as well that which the railway company should thereafter acquire, as the property which it then owned, and wheresoever situate; it being the declared intention of the railway company, as expressed in said deed of trust, to grant, transfer, and convey to the said Mercantile Trust Company of San Francisco, as trustee, all the corporate property and franchises then belonging to the said Ocean Shore Railway Company, or which the Ocean Shore Railway Company might thereafter acquire.

IV.

That said properties, and each and all of them, were so granted, transferred and conveyed by said Ocean Shore Railway Company to said Mercantile Trust Company of San Francisco, upon certain uses and trusts in said deed of trust set forth and defined, and more particularly for the purpose of securing the payment of five thousand bonds therein provided

to be issued by said Ocean Shore Railway Company, and to be certified by said Mercantile Trust Company of San Francisco, of the denomination of One Thousand Dollars (\$1,000.00) each, together with interest thereon at the rate of five per cent (5 per cent) per annum; and for the equal and proportionate benefit and security of all holders of the bonds and coupons issued or to be issued under and secured by said deed of trust, and for the enforcement of the payment of the said bonds and interest when payable, according to the tenor, purport and effects of such bonds and coupons, and to secure the performance and observance of and compliance with the covenants and conditions of said deed of trust, without preference, priority or distinction as to lien, or otherwise, of one bond over any other bond by reason of priority in the issue, sale or negotiation thereof, or by reason of the purport of its issue; so that each and every bond issued and to be issued under said deed of trust should have the same right, lien and privilege, under and by virtue of said deed of trust; and so that the principal and interest of every such bond should, subject to the terms thereof, be equally and proportionately secured by said deed of trust, as if all had been duly issued, sold and negotiated simultaneously with the execution and delivery of said deed of trust. [51]

V.

That thereafter said Ocean Shore Railway Company did issue, and upon request of said Ocean Shore Railway Company, said Mercantile Trust Company of San Francisco did certify and deliver, to said Ocean Shore Railway Company, said five thousand

(5000) bonds of the denomination of One Thousand Dollars (\$1000) each, and bearing interest at the rate of five per cent (5 per cent) per annum, all of which bonds, except bonds of the face value of Forty-five Hundred (4500) Dollars ever since have been, and now are, outstanding and unredeemed, and are owned and possessed by, or pledged as collateral security to, numerous persons, co-partnerships and corporations, who purchased and acquired the same, or received the same in such pledge, in good faith and for a valuable consideration.

VI.

That said bonds, and each and all of them, were so issued by said Ocean Shore Railway Company, and so certified and delivered by Mercantile Trust Company of San Francisco to said Ocean Shore Railway Company, and all of said bonds, excepting only bonds of the face or par value of Forty-five Hundred (4500) Dollars were, by said Ocean Shore Railway Company, sold, and delivered or pledged to, and were purchased by, or received in pledge by the respective owners or holders thereof, for value, in due course, and subject to the terms, conditions and provisions of said deed of trust and to all of them, and to certain covenants in said deed of trust set forth and declared on the part of said Ocean Shore Railway Company to be kept and performed, and herein more particularly said Ocean Shore Railway Company did, in and by said deed of trust, especially covenant and agree that, all and singular, the said properties and franchises in said deed of trust set forth and described, should be held by said Mercan-

tile Trust Company of San Francisco, a corporation, as trustee, for the equal and proportionate benefit and security of all owners or holders of the bonds and coupons issued under and secured by said deed of trust, and for the enforcement of the payment of said bonds and interest when payable, according to the tenor, purport and effect of said bonds and coupons, and to secure the performance and observance of and compliance with the covenants and conditions of said deed of trust, as hereinbefore more particularly specified and declared; and which said bonds were in said deed of trust declared to be a first lien upon all of the properties of said Ocean Shore Railway Company in said deed of trust set forth and described.

VII.

That in and by said deed of trust, and more particularly in and by the provisions of Article III thereof, said railway [52] company did covenant and agree, duly and punctually to pay the principal and interest of the said bonds in gold coin of the United States of America, at the dates and places and in the manner mentioned in said bonds and in the coupons thereto without deduction of either principal or interest for any tax or taxes which might be imposed, or which said Railway Company might be required to pay or retain therefrom, under any present or future law of the United States of America, or any state, county or municipality therein.

VIII.

That said Ocean Shore Railway Company has not duly or punctually, or otherwise, paid the interest

due upon said bonds issued under and secured by said deed of trust, at the dates and places, or in the manner, mentioned in said bonds or the coupons thereunto belonging, according to the true intent or meaning thereof; but that on the contrary, said Ocean Shore Railway Company has failed, neglected and refused to pay the interest which fell due upon said bonds, according to the provisions thereof and of said deed of trust, on the first day of November, 1909, and on the first day of May, 1910, or any part thereof, and the interest so falling due upon said bonds on said first day of November, 1909, and on said first day of May, 1910, was not, nor was any part thereof, on said dates, or either of them, paid by said Ocean Shore Railway Company, nor has the same, nor any part thereof, been since paid by said Ocean Shore Railway Company to said Mercantile Trust Company of San Francisco, trustee, or to anyone else, and that said interest upon said bonds so falling due as aforesaid, ever since has been, and is now, wholly due, owing and unpaid.

IX.

That in and by the provisions of said deed of trust, and more particularly in and by the provisions of Articles IV and V thereof, it is expressly covenanted and agreed by said Ocean Shore Railway Company, that if default shall be made in the payment of any interest upon any bonds thereby secured, and any such default shall continue for a period of ninety days, or in case default shall be made in the payment of the principal of any such bonds, or in case default shall be made in the due observance or performance

of any other covenant or condition required to be kept or performed by said Ocean Shore Railway Company, and if such default shall continue for a period of ninety days after written notice thereof from the trustee, or from the holders of five per centum (5 per cent) or more in amount of the bonds secured thereby, or in case the said Ocean Shore Railway Company should become insolvent or [53] bankrupt, the trustee might, and upon the written request of the holders of a majority of the amount of the bonds secured thereby, shall, by a notice in writing, declare the principal of all bonds secured thereby, and outstanding, to be forthwith due and payable, and that the said principal and interest should thereupon become and be immediately due and payable, anything in said indenture or in said bonds contained to the contrary notwithstanding.

X.

That in and by said deed of trust, and more particularly in and by the provisions of Article VI thereof, said Ocean Shore Railway Company did expressly covenant and agree that, should it make default whereby the security created by said deed of trust should become enforceable, the trustee might, at its option, sell to the highest bidder, and in one lot or in parcels, all and singular, the trust property and all right, title and interest therein and thereto, which sale should be at public auction, in the City and County of San Francisco, State of California, or at such other place and at such other time and upon such other terms, as the trustee might fix; and in the event of such sale and the exercise of such power

of sale by said trustee, said Ocean Shore Railway Company covenanted and agreed to join in any deed of conveyance or other writing evidencing such sale; and for that purpose and to that end, the said Ocean Shore Railway Company did covenant and agree that said trustee should be, and the same was, thereby appointed the true and lawful attorney irrevocably of the said Ocean Shore Railway Company, in its name and stead to make all necessary deeds of conveyance and transfer of said property, and to make and execute all necessary acts of conveyance, assignment and transfer necessary or required to fully effect and accomplish the transfer and conveyance of said property so to be sold as aforesaid; and said Ocean Shore Railway Company did thereby and therein further ratify and confirm all that its said attorney or attorneys should lawfully do by virtue thereof.

XI.

That in and by the terms and provisions of said deed of trust, and more particularly in and by the terms and provisions of Article IX thereof, said Ocean Shore Railway Company did covenant and agree that in case of sale of the properties thereby conveyed, or any part thereof, under said power of sale, the purchasers of said properties at such sale, for the purpose of making settlement or payment for the properties purchased, and in discharge of the purchase price thereof, should be entitled to turn in or apply toward the payment of the purchase price and should be entitled to be credited with any bonds issued under said deed of trust, and any matured [54]

and unpaid coupons and interest to the extent of the value of, or amount which would be payable upon, such bonds and coupons, upon a distribution among the bondholders of the net proceeds of such sale, after making the deduction allowed under the terms of said deed of trust, for the costs and expenses of the sale and otherwise; and did further covenant and agree that, upon the surrender of said bonds and coupons for such purpose, such bonds and coupons so received and applied in payment of such purchase price should be deemed to be paid only to the extent so applied; and that at such sale, the trustee or any bondholder, or their agents, might bid for and purchase such property, franchises and premises, and might make payment therefor as aforesaid, and upon compliance with the terms of sale, might hold, retain and dispose of said property, franchises and premises without further accountability.

XII.

That upon the 12th day of May, 1910, Mercantile Trust Company of San Francisco did make, execute and deliver to J. Downey Harvey, president of said Ocean Shore Railway Company, and to said Frederick S. Stratton, the duly appointed, qualified and acting receiver thereof, notice that Mercantile Trust Company of San Francisco, trustee as aforesaid, did, by reason of the default of said Ocean Shore Railway Company in its failure, refusal and neglect to pay the interest due and payable on November 1, 1909, upon Coupon Number 8 attached to said bonds, and by reason of the continuance of said default for a period of more than ninety days, declare both prin-

principal and interest on said bonds secured by said deed of trust, then outstanding, to be forthwith due and payable, anything in said deed of trust or in said bonds to the contrary notwithstanding.

XIII.

That thereupon, and in virtue of said notice and declaration, the principal and interest upon said bonds and the coupons thereto attached, did immediately become due and payable from said Ocean Shore Railway Company to said bondholders, anything in said deed of trust or in said bonds to the contrary notwithstanding, and that neither said principal or said interest so due and payable upon said bonds, or either thereof, or any part thereof, has ever been paid by said Ocean Shore Railway Company, or by anyone else, but that the whole of said principal and interest, and both thereof, ever since have been, and now are, wholly due, owing and unpaid.

XIV.

That thereafter, and on the 7th day of June, 1910, said Mercantile Trust Company of San Francisco, as such trustee under said deed of trust, and in the exercise and discharge of [55] the powers and authorities conferred and the duties imposed upon it by said deed of trust, for the purpose of foreclosing and rendering effective the provisions of said deed of trust, and of realizing from the properties covered thereby the payment of the bonded indebtedness thereby secured, did cause notice of trustee's sale to be published in the "The Recorder," a newspaper of general circulation throughout the City and County

of San Francisco, and throughout the State of California, of the sale of the properties of the Ocean Shore Railway Company, at public auction, such sale to be made on Thursday, the first day of September, 1910, at the hour of twelve o'clock noon of that day, at the entrance to the office of Mercantile Trust Company of San Francisco, Number 464 California Street in the City and County of San Francisco, State of California, or at such other time to which such sale might be regularly postponed; and did cause such notice of trustee's sale to be published once a week for five successive weeks in said newspaper.

XV.

That thereafter, and on said first day of September, 1910, at the hour of twelve o'clock noon of said day, at the entrance of the office of said Mercantile Trust Company of San Francisco, Number 464 California Street, in the City and County of San Francisco, State of California, the said Mercantile Trust Company of San Francisco did adjourn such sale and cause the said sale to be adjourned, by announcement at the said time and place, and did thereby postpone the same to the 15th day of October, 1910, at the hour of twelve o'clock noon of said day.

XVI.

That this court now finds that said Ocean Shore Railway Company has been operated during the term of said receivership, and for many months prior thereto, and must be continued to be operated in the present condition of said property, at the loss, and to the disadvantage, of the bondholders and

other creditors of said Ocean Shore Railway Company; that, as the court now finds, the immediate sale and disposition of said property is necessary for the protection of said bondholders and other creditors of said Ocean Shore Railway Company and of the security thereby afforded, and for the satisfaction of the claims of said bondholders and said creditors, and other obligations; and that unless immediate sale and disposition of said property is effected, the value of said properties will further decrease and be rendered nearly, if not entirely, worthless.

XVII.

That the value of all of said properties of said Ocean [56] Shore Railway Company, as at present constituted, is not sufficient, and that there cannot and will not be realized from the sale of said properties moneys sufficient to discharge or meet the bonded indebtedness secured by said deed of trust, and now issued and outstanding against said Ocean Shore Railway Company. That there will not and cannot be realized from the sale of said properties, or any, or otherwise, any amount or amounts equal to the amount of said bonded indebtedness, or equal to anything in excess of three-fifths of the said bonded indebtedness; but that on the contrary, at the present value of said properties, and upon the sale of all the properties of said railroad company as aforesaid, and the realization therefrom of the full value thereof, there will still remain due and unpaid to the holders of said bonds, a sum or deficiency in excess of two-fifths of the par value of said bonds. That nevertheless the properties of said Ocean Shore

Railway Company are reasonably worth the sum of One Million (1,000,000) Dollars, and should not be sold by said Mercantile Trust Company of San Francisco, or any one else, nor should any bid for said properties of said Ocean Shore Railway Company be received by said Mercantile Trust Company of San Francisco or anyone else, for a less sum than One Million Dollars (\$1,000,000), which sum of One Million Dollars (\$1,000,000) the court now finds is the minimum amount of any bid which should be received or accepted at such sale as the purchase price of said properties.

XVIII.

That it is for the best interests of said bondholders and all others having or claiming any interest in said properties, that the same should be forthwith sold.

XIX.

That certain persons, firms and corporations assert certain claims against the Ocean Shore Railway Company, which said claims are claimed to have been incurred prior to the 6th day of December, 1909, the date of the appointment of said Receiver, and are claimed to be entitled to be paid out of the proceeds of the sale of said property, prior to the payment of the bonds described in said deed of trust. That said claims have been referred to, but have not been reported upon by, the Master in Chancery, or finally passed upon by this court, but said claims, entitled to such payment, this court now estimates, for the purpose of advising intended purchasers of the total amount thereof, do not exceed in an approximated

aggregate, the total sum of One Hundred Thousand (100,000) Dollars.

XX.

That during the administration of said receivership of [57] said Frederick S. Stratton, it is claimed by divers persons, firms and corporations that said receiver has contracted and incurred certain obligations, in the operation and maintenance of said Ocean Shore Railway Company, a statement of the amount of which has been made to appear to this court by full, true and detailed report which has been filed by said receiver in open court, on the 6th day of September, 1910, and by oral evidence, and which asserted obligations, in the aggregate, the court finds equal the total sum of Ninety-one thousand nine hundred twenty-one and 2-100 (91,921.02) Dollars.

XXI.

That said Mercantile Trust Company of San Francisco, said bondholders, and certain other persons in interest, resist the payment of certain of said asserted obligations set forth in said detailed statement and hereinafter set forth in detail, and contend that the same are not entitled to be paid out of the proceeds of any sale of said properties; that, except for the obligations hereinafter set forth in detail, as aforesaid, all other obligations set forth in said detailed statement, filed herein on the 6th day of September, 1910, are entitled to be paid out of the proceeds of the sale of said properties.

XXII.

That from the date of this order, to the date within

which any purchaser at the sale herein ordered, will be required to complete such purchase and take possession of said properties, the receipts from the operation of said railway company by said receiver will be ample to pay all additional obligations to be hereafter incurred by him under the orders of this court, and will also be sufficient to pay the interest, if any, which may accrue upon all receiver's notes, which this court has, by its order, or shall ultimately by subsequent order, determine are entitled to be paid.

XXIII.

That of the said sum of Ninety-one thousand nine hundred and twenty-one and 02-100 (91,921.02) Dollars, said Trustee, bondholders and other parties in interest contend that the sum of Forty-one thousand six hundred and one and 91-100 (41,601.91) Dollars has not been incurred by the said Receiver, and that the items composing and constituting the same are not proper or necessary charges against said Receivership, and that the said Receivership is not under any obligation to pay or discharge the same, and that no part of the said sum should be paid by the said Receiver, nor should the same or any part thereof be paid from or charged against the proceeds of the sale of said properties. [58]

XXIV.

That the said items composing and included in said sum of Forty-one thousand six hundred and one and 91-100 (41,601.91) Dollars, and to the payment of which objection is so made and reserved as aforesaid, and to which reference has been made

in paragraph XXI of this order, are the following, to wit:

[59]

Name of Claimant.	Amount Claimed.	Amt. Incurred prior to Dec. 6, 1910.	Interest Claimed.	Evidenced by.	Total.
Boyce Lumber Co., and E. J. Boyce	(2) \$ 300.00	\$14.51	\$9.93	Note	
Boyce Lumber Co., E. J. Boyce and Mary Bates	(2) 600.00	29.03	19.82	Note	
Boyce, E. J.	(2) 200.00	9.68	6.60	Note	
Collins, Gertrude	(7) 6,666.66	3,277.42	197.65	Note	
Gillis, R. C. and Clark, E. P.	777.00		.15	Note	
Lilly, C. E. and Heins, R. W.	1,260.00		32.43	Note	
Malony, P.	1,340.00	547.65	16.15	Note	
O'Connor, E. Est. of	2,500.00	1,298.39	48.93	Note	
	<u>13,643.66</u>	<u>5,176.68</u>	<u>331.66</u>		\$13,643.66

Name of Claimant.	Amt. Incurred Subsequent to Dec. 6, 1910.	Evidenced by.	Total
Standard Oil Company.....	\$2,260.38	Vouchers Payable	2,260.38
Advances to Receiver.....	1,131.88	Open Account	
Heins, R. W.....	1,584.00	" "	
Lilly & Heins.....	3,525.00	" "	
Warren Co., C. A.....	4,248.00	" "	
Brenn Morris.....	1,422.00	" "	
			11,910.88
Boyce Lbr. Co., and E. J. Boyce	285.39	Rentals Payable " "	
Boyce, E. J., Boyce L. Co., and M. Bates.....	545.97	" "	
Boyce, E. J.....	182.16	" "	
O'Neill, R.....	5,152.25	" "	
Malony, P.	273.00	" "	
O'Connor, W. & L.....	750.00	" "	
Harlow, I.	195.16	" "	
Clark, M.	1,092.90	" "	
Cal. Car Mnfg. Co.....	1,746.99	" "	
Schubert, Wm.	78.07	" "	
Center, John	1,951.61	" "	
Stone Co., E. B. & A. L.....	601.83	" "	
			\$12,855.33
			41,001.91
Claims for Rentals for Rights of Way.....			600.00
			<u>\$41,601.91</u>

XXV.

That it is necessary at this time to fix and determine the fees to be paid to said Receiver for his services to date, and for all services which he may hereafter perform until the final settlement of his accounts and the close of his Receivership; and that it is further necessary at this time to determine a reasonable compensation to be allowed to the attorney for said Receiver, for all services rendered up to the date of this order and hereafter to be rendered until the settlement of the final accounts of the Receiver and the close of his Receivership; and the Court now finds that the sum of Five hundred (500) Dollars per month is a reasonable sum to be paid to said Receiver during the continuance of said Receivership, but in no event for a longer period than fifteen months from the 6th day of December, 1909, and to be allowed to the Receiver for all services rendered and hereafter to be rendered by him, until the completion of his Receivership and the settlement of his final accounts and his final discharge, and that the sum of One thousand (1,000) Dollars per month be paid to the attorney for said Receiver during the continuance of said Receivership, but in no event for a longer period than fifteen months from the 6th day of December, 1909, is a reasonable sum to be allowed to the attorney for the Receiver, and to the Receiver for his attorney's fees, for all services rendered by the attorney to the Receiver, or required to be rendered by said attorney, or by any other attorney, to the Receiver, until the completion of his Receivership

and the settlement of his final accounts and his final discharge.

XXVI.

That the Court now finds that Mercantile Trust Company of San Francisco, trustee as aforesaid, is entitled to be allowed, according to the terms and provisions of said deed of trust, for the payment of costs, expenses fees of experts, and other charges of said sale, and for the payment of all expenses and liabilities incurred and advanced, and disbursements made and to be made, in connection therewith, by the said trustee, the total sum of Five thousand and twelve and 57-100 (5,012.57) Dollars.

XXVII.

And the court does further find that Mercantile Trust Company of San Francisco, as such trustee, is entitled to be allowed, under the provisions of said deed of trust, a reasonable compensation for its services in administering said trust, and in making said sale, and for the services of the agents and attorneys employed therein, and that the sum of Twelve thousand (12,000) Dollars would be, and is, hereby determined upon, fixed allowed and ordered paid, as a reasonable compensation [60] to said trustee, its agents and attorneys therefor.

XXVIII.

And it further appearing to the satisfaction of the court that the obligations claimed to have been incurred by, and asserted against said receivership, and exception and objection to the payment of which has been made and reserved by said trustee, said bondholders, and other parties in interest, and

as to which it is contended they are not entitled to be paid out of the proceeds of any sale of said properties, as set forth in said detailed statement and hereinbefore referred to in Paragraph XXIV of this order, amount in the aggregate to the sum of Forty-one thousand six hundred one and 91-100 (41,601.91) Dollars.

XXIX.

And it further appearing to the satisfaction of the court that the claims and demands, aggregating the said sum of Fifty thousand three hundred nineteen and 11-100 (50,319.11) Dollars, incurred by said receiver, and set forth in his said detailed statement, filed herein on the 6th day of September, 1910, and entitled to be paid out of the proceeds of any sale of said properties, together with the said sum of Forty-one thousand six hundred and one and 91-100 (41,601.91) Dollars, and the fees of the receiver and his attorney, and the expenses of said sale, and the compensation and disbursements of said trustee, its agents and attorneys, amount in all to the aggregate sum of One hundred and thirty-one thousand four hundred and thirty-three and 59-100 (131,433.59) Dollars.

XXX.

And it further appearing to the satisfaction of the court that upon the consummation of the sale hereby ordered, and upon the final delivery of possession of all properties in his hands by said receiver, there may remain a balance of cash in the hands of said receiver, over and above the costs and expenses necessarily and properly incurred by him,

the amount whereof shall be hereafter determined by the court, upon the settlement of the final account of said receiver.

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the consent and permission of this court be, and the same is hereby, given and granted to Mercantile Trust Company of San Francisco, and Mercantile Trust Company of San Francisco is hereby authorized and empowered, as trustee named in that certain deed of trust heretofore executed and delivered by the said Ocean Shore Railway Company grantor, to Mercantile Trust Company of San Francisco, trustee, dated November 1, 1905, and recorded in the office of the Recorder of the City and County [61] of San Francisco November 24, 1905, at one minute past ten o'clock A. M., in Liber 1412 of Mortgages, page 387, and Liber 165 of Personal Property Mortgages, page 361, and re-recorded in the office of the Recorder of the City and County of San Francisco February 13, 1908, at 55 minutes past twelve o'clock P. M., in Liber 28 of Mortgages, New Series, page 29, and Liber 11 of Personal Property Mortgages, New Series, page 341; and recorded in the office of the Recorder of Santa Cruz County, January 31, 1906, at nine o'clock A. M., in Volume 141 of Mortgages, page 38, and Volume 17 of Chattel Mortgages, at page 42, and recorded in the office of the Recorder of San Mateo County, January 23, 1906, at 30 minutes past three o'clock P. M., in Volume 6 of Chattel Mortgages, Page 553, and in Volume 40 of Mortgages, page 380; to proceed, in ac-

cordance with the terms and provisions of said deed of trust, and in the exercise of the powers vested in, and in the discharge of the duties imposed upon, said Mercantile Trust Company of San Francisco thereby, to sell and to make sale, either personally or by its agents or attorney, at public auction, in the City and County of San Francisco, State of California, to the highest bidder, in one lot or parcel, of the following described properties of said Ocean Shore Railway Company to wit:

All real property rights of way and terminals within the City and County of San Francisco and the Counties of San Mateo and Santa Cruz, State of California, and all of the railroads and railroad lines now owned by the Ocean Shore Railway Company within the City and County of San Francisco and Counties of San Mateo and Santa Cruz, in the State of California, including those railroads and railroad lines within said City and County and said Counties extending along and across certain streets, avenues and highways and over, along and across certain private rights of way within said City and County and said counties, commencing at the shore line of the Bay of San Francisco, in the State of California, on the easterly side of Waterfront street, twenty-five (25) feet southerly from where said street would be intersected by the southerly line of Army Street, if extended, in the City and County of San Francisco, State of California; thence westerly and southwesterly to a point at or near Ocean View in the City and County of San Francisco, State aforesaid; thence in a southwesterly direction to a point

near the shore line of the Pacific Ocean in said City and County of San Francisco, thence running southerly and southeasterly near the said shore line of the said Pacific Ocean to and through the counties of San Mateo and Santa Cruz to the City of Santa Cruz, in said County of Santa Cruz, State of California; thence entering said City of Santa Cruz and running to deep water off shore from mean [62] low tide near shore line of Monterey Bay within the said City of Santa Cruz to a point near the present site of the Pacific Coast Steamship Company's wharf in the City of Santa Cruz.

Also commencing within what is known as the Richmond District in the City and County of San Francisco, State of California, at the point where Eleventh avenue intersects Fulton Street; thence northerly along Eleventh avenue to A street; thence westerly along A street to Twenty-third avenue; thence southerly along Twenty-third avenue to C street; thence westerly along C street to Forty-eighth avenue; thence in a southerly direction crossing the westerly end of Golden Gate Park in said City and County, intersecting the main line hereinbefore described at some convenient point on the westerly side of a tract of land known as the Rancho Laguna de la Merced, and also connecting the last above described line by a like railroad commencing at the intersection of said Eleventh avenue and C street; thence westerly along C street to where the same intersects the line last above mentioned on Twenty-third avenue in said City and County of San Francisco, State of California.

Also all warehouses, railroads and railroad lines now owned by said Ocean Shore Railway Company, and all appurtenances to any and all of said warehouses, railroads and railroad lines and branches, including therein all rights of way, roadways, tracks, sidetracks, turnouts, sidings, branches, rails, switches, depots, station-houses, shops, warehouses, car-houses, engine-houses, power-houses, machine-shops, repair-shops, buildings, erections and structures, superstructures, bridges, rolling-stock cars, motor cars, trailers, equipment, machinery dynamos, poles, wires, electrical and mechanical appliances, fixtures, furniture, tools and implements now owned by the said Ocean Shore Railway Company.

And also all the franchises, rights of way, leases, licenses, consents, easements, rights, privileges and immunities relating or appertaining to said railroads or railroad lines and branches, or otherwise, and any and all extensions thereof or additions thereto, and all replacements or renewals of the same, or any part thereof, and all like property and estate which the said Ocean Shore Railway Company now possesses, owns or is entitled to.

And also all the estates, grants, rights, title, interest, possession, claim and demand whatsoever, as well in law as in equity, of the said Ocean Shore Railway Company of, in and to the said property and premises and every part and parcel thereof with the appurtenances thereunto belonging.

And any and all bonds and shares of stock of any other corporation or corporations now owned by said Ocean Shore Railway Company; [63]

And also all other property, whether real, personal or mixed, belonging to the said Ocean Shore Railway Company and wheresoever situated.

Together with all and singular the tenements, hereditaments and appurtenances thereunto belonging and appertaining or at any time held or enjoyed therewith by the said Ocean Shore Railway Company, and the reversion and reversions, remainder and remainders, rents, tolls, incomes, issues, and profits thereof, with all the right, title, interest, estate, property, possession, claim and demand whatsoever, as well in law as in equity, of the said Ocean Shore Railway Company, of, in and to the same, or any part or parcel thereof.

AND IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said consent, permission and authority to sell and make said sale as aforesaid, is granted upon the following express conditions, and not otherwise:

1. That said sale shall be made for cash, in gold coin of the United States of America of the present standard of weight and fineness, and for no less sum than One Million Dollars (\$1,000,000).

2. That there shall be paid by the person, firm or corporation who shall be the purchaser at such sale, to Mercantile Trust Company of San Francisco on the fall of the hammer one hundred thirty-one thousand four hundred thirty-three and 59 100 (131,433.59) Dollars in cash, as hereinafter provided, which said sum of one hundred thirty-one thousand, four hundred thirty-three and 59.100 dollars, in cash, shall, by said Mercantile Trust Company of San

Francisco, be expended and applied as follows, to wit:

First: It shall discharge the obligations, incurred by it in the administration of said trust and the consummation of said sale, including the payment of costs, expenses, fees, and other charges thereof, amounting in the aggregate to the total sum of Seventeen thousand twelve and 57.100 (17,012.57) Dollars.

Second: It shall pay to F. S. Stratton, as such receiver, out of the moneys so received, the sum of Seventy-two thousand eight hundred and nineteen and 11.100 (72,819.11) Dollars, being the expenses necessarily and properly incurred by the said F. S. Stratton as such receiver, and which expenses and obligations are not contested by any party or inter- vener to this action.

Third: It shall retain in its custody and possession the sum of Forty-one thousand six hundred one and 91.100 (41,601.91) Dollars in cash, being the amount of contested obligations asserted or claimed to have been incurred by said receiver, the items composing and included in which said sum are set forth in Paragraph XXIV of this order, and which said sum of Forty-one [64] thousand six hundred one and 91.100 (41,601.91) Dollars shall be retained by said Mercantile Trust Company of San Francisco, and paid out only in satisfaction of a final judgment of a court of competent jurisdiction directing the payment of said items or upon any final order of this Court. A certified copy of any such judgment or order shall be accepted by said Mercantile Trust Company of San

Francisco, and said Mercantile Trust Company of San Francisco shall be entitled to receive and accept such certified copy of any such judgment, or order, as conclusive evidence of its right to make such payment, and shall be protected thereby in making the same. When by a final judgment or judgments of a court or courts of competent jurisdiction, or by such final order, the rights of all of the claimants to said last-named sum shall have been determined, and upon the production of such certified copy of such judgment or such order, such payments have been made, the balance of said sum, if any, remaining in the hands of Mercantile Trust Company of San Francisco, shall be forthwith paid to said bondholders, their successors or assigns, in equal proportions.

3. The said sum of Seventy-two thousand eight hundred nineteen and 11.100 (72,819.11) Dollars, so paid by said Mercantile Trust Company of San Francisco to said receiver, shall be by him expended and applied, and he is hereby authorized and directed to apply the same, as follows, to wit:

(a). In discharging and paying obligations of said receivership, amounting in all to the total sum of Fifty thousand three hundred and nineteen and 11.100 (50,319.11) Dollars, hereinbefore referred to, and particularly itemized and specified in the account and report of said receiver, heretofore filed in open court on the 6th day of September, 1910, the payment of which several items of indebtedness so incurred by said receiver, is not contested by any party to this action or any intervener herein, and which obligations are entitled to be paid out of the

proceeds of the sale of said property, as hereinbefore found.

(b). Said receiver shall, and he is hereby authorized and directed to, pay from said sum of Seventy-two thousand eight hundred nineteen and 11.100 (72,819.11) Dollars, to his attorney, the sum of One thousand (1,000) dollars per month, from the date of the appointment of said receiver, to wit, the 6th day of December, 1909, for the period of fifteen (15) months, and shall pay to himself as such receiver, the sum of Five hundred (500) Dollars per month from said 6th day of December, 1909, for the period of fifteen (15) months, provided said receivership shall continue so long. In the event that said receivership shall be sooner terminated, said payments shall terminate, and said receiver shall account to this [65] court for any moneys remaining unexpended hereunder. Said payments to said receiver and to his attorney shall be made and accepted by said receiver and his attorney, in full compensation and payment for all services heretofore and hereafter to be rendered during the period of said receivership, whether said receivership shall terminate during said period of fifteen (15) months, or shall be continued beyond said period of fifteen (15) months.

4. That the payment of the balance of the purchase price of said properties shall be made as herein provided, within forty-five (45) days from the date of said sale, and upon the execution and delivery by said Mercantile Trust Company of San Francisco, as such trustee and attorney in fact of

said Ocean Shore Railway Company, to the purchaser or purchasers, his or their successors or assigns, of the proper instruments of conveyance, transferring, granting and conveying to said purchaser or purchasers, his or their successors or assigns, all of the right, title and interest of the said Ocean Shore Railway Company, in and to said properties and the whole thereof; provided, however, that such sale and transfer and conveyance of said properties shall be made, subject to the payment of the several claims against said Ocean Shore Railway Company, and claimed to have been incurred by said Ocean Shore Railway Company prior to the 6th day of December, 1909, which this court shall, by final judgment and decree, determine to be entitled to priority of payment over the bonds in said deed of trust described (which claims have not yet been reported by the Master in Chancery, or passed upon by this court,) but which said claims this court has heretofore estimated, for the purpose of advising the purchaser at the sale of said properties, will not exceed, in the approximated aggregate, the total sum of One hundred thousand (100,000) Dollars; and subject also to the right of any purchaser or purchasers, his or their successors or assigns, at any such sale to deposit with the clerk of this court First Mortgage Sinking Fund Gold Bonds of the face or par value of Two hundred thousand (200,000) Dollars, which said bonds shall form a part of an issue not exceeding Four million (4,000,000) Dollars, and bearing interest at not less than five per cent (5 per cent) per annum, the payment of which shall have been

secured by a first mortgage on the right, title and interest acquired by the purchaser in and to all the properties hereinbefore described of said Ocean Shore Railway Company, and upon the payment of said claims, or the deposit with the clerk of this court of such bonds as aforesaid, the said properties shall be released from the liens of said claims, and the title of the purchaser or purchasers, his or their successors [66] or assigns, shall thereupon be and become absolute against all persons whomsoever, claiming to be entitled to priority of payment over the bonds described in said deed of trust, executed by the Ocean Shore Railway Company to Mercantile Trust Company of San Francisco, and the certificate of the clerk of this court, certifying to the fact that such bonds in such amount have been so deposited with him, shall be conclusive evidence of that fact, and of the discharge and release of said properties, and of each and all of them, from the said liens. Said bonds shall be held by said clerk as security for the payment of such claims, or any of them, as shall be determined and adjudged, by this court, by final judgment or order, to be entitled to priority, and as may be ordered to be paid by this court by such final judgment or order, prior to the payment of the bonds now issued and outstanding under said deed of trust, and shall also be security for the expenses of this proceeding hereinafter incurred and not herein otherwise provided for, and for the fees of the Master in Chancery herein; provided always that all questions in regard to the validity, allowance, payments or priority of said claims, or any of them,

are hereby reserved for the future orders and adjudications of the Master in Chancery and of this court. That after the payment and satisfaction of all of said prior liens and claims so ascertained and ordered to be paid as aforesaid, such payments and satisfaction to be evidenced by the presentation to the clerk of this court of receipts for the amount of such claims, signed by the owners thereof, their successors or assigns, or the deposit with said clerk of an amount in cash sufficient to pay and discharge the same, as the case may be, the person, firm or corporation who shall have deposited such bonds with the clerk, as aforesaid, his or their successors or assigns, may at any time withdraw the bonds so deposited, or such number thereof as shall then remain in the custody of said clerk; provided, however, that the person, firm or corporation who shall have deposited such bonds, his or their successors or assigns, may, at any time, upon making such deposit in cash or upon making deposit in cash of an amount sufficient to pay any portion less than all of said claims, or upon presenting to the clerk of such receipts, evidencing the payment of any of such claims, be entitled to withdraw bonds so deposited at the rate of one dollar and fifty cents (\$1.50) in face value of such bonds, for every dollar in face value of such claims so satisfied and discharged, or to satisfy and discharge which such cash shall be deposited as aforesaid; provided always, however, that in the event of the sale of said bonds under order of this court, for the purpose of enforcing such security and of satisfying any such established [67] claim or claims,

the clerk of this court shall detach from such bond so sold, before delivery thereof to the purchaser at such sale, all matured and unpaid coupons, which matured and unpaid coupons so detached, shall be by said clerk returned to the depositor or depositors thereof, his or their successors or assigns.

5. The purchaser or purchasers at such sale, for the purpose of making settlement or payment of so much of the purchase price of the property purchased as shall remain unpaid, after the payment of the cash hereinbefore required to be paid, on the fall of the hammer, and upon the execution and delivery of proper instruments of conveyance, shall be entitled to turn in to the trustee, and apply toward the payment of said balance of the purchase price, and shall be entitled to be credited with, and the said trustee is hereby authorized and empowered to accept, as provided in said deed of trust, bonds issued and outstanding under said deed of trust, the payment of which is secured thereby, and any matured and unpaid coupons and interest upon any bonds so issued, outstanding and secured, said bonds and coupons being receivable and to be received, and credited upon such purchase price, for such an amount as shall be equal to the distributive share which the holders of each of such bonds and coupons shall be entitled to receive out of the net proceeds of such sale, as provided in said deed of trust, after making the deductions on account of the cash required to discharge the obligations of said receivership and the fees, costs and expenses of said trustee and said sale; and provided further that, if it shall

appear that any of said bonds and coupons have been pledged by said Ocean Shore Railway Company, and are at the date of said sale so held in pledge to secure the payment of any sum of money due or owing by said Ocean Shore Railway Company, the distributive amount which shall be paid upon said bonds or coupons so held in pledge, or the amount for which they may be applied in the payment of the purchase price, shall not exceed the amount of the obligations which they are so pledged to secure, or, if the amount of such obligation is equal to or in excess of the distributive share of all bonds, then only to the amount of such distributive share; and provided always, such bonds, coupons and interest, when so applied in payment by the purchaser or purchasers, shall be deemed to be paid only to the extent to which they may be so applied.

6. Nothing in this order contained, shall be understood or construed as determining or establishing the validity, allowance, amount or priority of any claim or claims, now or hereafter asserted against said Ocean Shore Railway Company, [68] or as determining or establishing any priority of lien, equitable or otherwise, in favor of any of the obligations of said Ocean Shore Railway Company, claimed or asserted to have been contracted or incurred prior to the appointment of such receiver, but the determination and adjudication of the validity, allowance, amount or priority of any such obligations are hereby expressly reserved for future adjudication. In case the purchaser or purchasers at such sale, his or their successors or assigns, shall become possessed,

by purchase or otherwise, of any of such claims or obligations hereinbefore referred to, such purchaser or purchasers, his or their successors or assigns, shall thereupon be subrogated to the rights of the original holders of such claims or obligations, and such purchaser or purchasers, his or their successors or assigns, shall be, and are hereby, permitted to appear in any and all proceedings which may thereafter be taken in the matter of said receivership, and prosecute and defend in any matter affecting the rights of any such purchaser or purchasers, his or their successors or assigns, which may be now or hereafter pending in said matter, to the same effect as if said purchaser or purchasers, his or their successors or assigns, had theretofore been parties to said proceeding.

7. That upon the consummation of such sale, and the payment of the purchase price, as aforesaid, and the execution and delivery of such instruments of conveyance, said F. S. Stratton, receiver as aforesaid, shall immediately turn over and deliver possession of such properties, and of each and all of them, to the purchaser or purchasers thereof, his or their successors or assigns.

8. AND IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, upon the signing and filing of this order, said Mercantile Trust Company of San Francisco, as trustee, shall readvertise and renounce the sale of such properties, at least once a week, for a period of not less than four (4) weeks, and as in said deed of trust provided, in a newspaper of general circulation throughout the City and

County of San Francisco, and the State of California, which said advertisement and notice, with the blanks therein appearing properly filled, shall be substantially in the words and figures following to wit:
[69]

**Notice of the Trustee's Sale of the Properties of the
Ocean Shore Railway Company Under Permis-
sion of the Circuit Court of the United States.**

WHEREAS, Ocean Shore Railway Company, a corporation organized and existing under the laws of the State of California, did heretofore, under date of November 1, 1905, make, execute, and deliver a certain deed of trust, wherein the undersigned Mercantile Trust Company of San Francisco, a corporation organized and existing under the laws of the State of California, is named as trustee, and which deed of trust was recorded in the office of the County Recorder of the City and County of San Francisco, State of California, on November 24, 1905, in Liber 1412 of Mortgages, at 387 and following, and was also recorded in the office of said County Recorder of the City and County of San Francisco on said November 24, 1905, in Liber 165 of Personal Property Mortgages, at page 361 and following, and was re-recorded in the office of said County Recorder of the City and County of San Francisco on February 13, 1908, in Liber 62 of Mortgages (New Series), at page 29 and following, and was also re-recorded in the office of said County Recorder of the City and County of San Francisco on January 30, 1908, in Liber 11 of Personal Property Mortgages (New Series), at

page 241 and following; and which deed of trust was also recorded in the office of the County Recorder of Santa Cruz County, State of California, on January 31, 1906, in Volume 141 of Mortgages, at page 38 and following; and was also recorded in the office of said County Recorder of Santa Cruz County on said January 31, 1906, in Volume 17 of Chattel Mortgages, at page 42 and following; and which deed of trust was also recorded in the office of the County Recorder of San Mateo County, State of California, on January 23, 1906, in Volume 6 of Chattel Mortgages, at page 553 and following, and was also recorded in the office of said County Recorder of San Mateo County on said January 23, 1906, in Volume 40 of Mortgages, at page 380 and following; and which deed of trust was so made, executed and delivered by said Ocean Shore Railway Company to Mercantile Trust Company of San Francisco, to secure the payment of both principal and interest of a bonded indebtedness theretofore created by said Ocean Shore Railway Company evidenced by certain bonds with interest coupons attached, as described and provided in said deed of trust, and which deed of trust covers all of the properties of said Ocean Shore Railway Company theretofore and thereafter acquired by it; and

WHEREAS, Said Mercantile Trust Company of San Francisco, as trustee aforesaid under said deed of trust, in the exercise and discharge of the powers and authorities conferred, and the duties imposed, upon it by said deed of trust, did, heretofore, serve upon said Ocean Shore Railway Company and upon

F. S. Stratton, claiming to be the duly appointed, qualified and acting receiver of said Ocean Shore Railway Company, a written notice, declaration and demand, notifying said Ocean Shore Railway Company and F. S. Stratton, claiming to be such receiver, that said Ocean Shore Railway Company had defaulted in the payment of interest on the bonded indebtedness of said Ocean Shore Railway Company secured to be paid by the aforesaid deed of trust; declaring said Ocean Shore Railway Company to be in default under the terms and provisions of said deed of trust, and of the bonds issued thereunder, and declaring the principal of all bonds secured by said deed of trust, and now outstanding, together with the interest thereon, to be forthwith due and payable, and that the said principal and interest was, and each of them is, immediately due and payable, anything in said deed of trust or in said bonds contained to the contrary notwithstanding; and demanding of said Ocean Shore Railway Company that it immediately pay to said Mercantile Trust Company of San Francisco, as trustee under said deed of trust, the full amount of the principal of all bonds secured by said deed of trust, and now outstanding, together with the interest thereon; and

WHEREAS, Said Ocean Shore Railway Company has failed, neglected and refused to make payment of the principal and interest now due on said bonds secured by said deed of trust, and now outstanding, and is in default in the payment thereof:

AND WHEREAS, heretofore, to wit, on the 6th

day of December, 1909, in the matter of Baldwin Locomotive Works, a corporation, Plaintiff, vs. Ocean Shore Railway Company, a corporation, Defendant, numbered 15,008 on the files of the Circuit Court of the United States, in and for the Ninth Circuit, Northern District of California, a receiver of the property of said Ocean Shore Railway Company was appointed by said Circuit Court; and

WHEREAS, thereafter, and on the 17th day of September, 1910, permission was given and granted unto Mercantile Trust Company of San Francisco, as such trustee to proceed in the exercise and discharge of the powers and authorities conferred and the duties imposed upon it by said deed of trust, for the purpose of foreclosing and rendering effective the provisions of the said deed of trust and of realizing from the properties covered thereby, the payment of the bonded indebtedness thereby secured, subject to certain terms and conditions in said order of said Circuit Court of the United States set forth and contained, to which said order of said Circuit Court intending purchasers of [70] said property are hereby referred for further particulars;

NOW, THEREFORE, the undersigned, said Mercantile Trust Company of San Francisco, a corporation, as trustee, under said deed of trust, in the exercise and discharge of the powers and authorities conferred and the duties imposed upon it by said deed of trust, and for the purpose of foreclosing and rendering effective the provisions of said deed of trust, and of realizing from the properties covered thereby, the payment of the bonded indebtedness thereby se-

cured, and under and in accordance with the permission thereunto granted by said order of said Circuit Court of the United States.

DOES HEREBY GIVE PUBLIC NOTICE that on Wednesday, the 19th day of October, A. D. 1910, at the hour of 12 o'clock noon of that day, and at the entrance to the office of Mercantile Trust Company of San Francisco, No. 464 California street, in the City and County of San Francisco, State of California, it will sell at public auction, as a whole in one parcel, to the highest bidder, for cash in United States gold coin, all of the following described properties of the said Ocean Shore Railway Company, to wit:

All real property, rights of way and terminals within the City and County of San Francisco and the Counties of San Mateo and Santa Cruz, State of California, and all of the railroads and railroad lines now owned by the Ocean Shore Railway Company within the City and County of San Francisco and Counties of San Mateo and Santa Cruz, in the State of California, including those railroads and railroad lines within said City and County and said counties, extending along and across certain streets, avenues and highways and over, along and across certain private rights of way within said City and County and said counties, commencing at the shore line of the Bay of San Francisco, in the State of California, on the easterly side of Waterfront street, twenty-five (25) feet southerly from where said street would be intersected by the southerly line of Army street, if extended, in the City and County of San Francisco,

State of California; thence westerly and southwesterly to a point at or near Ocean View in the City and County of San Francisco, State aforesaid; thence in a southwesterly direction to a point near the shore line of the Pacific Ocean in said City and County of San Francisco; thence running southerly and southeasterly near the said shore line of the said Pacific Ocean to and through the counties of San Mateo and Santa Cruz to the City of Santa Cruz, in said County of Santa Cruz, State of California; thence entering said City of Santa Cruz and running to deep water off shore from mean low tide near shore line of Monterey Bay within the said City of Santa Cruz to a point near the present site of the Pacific Coast Steamship Company's wharf in the City of Santa Cruz;

Also commencing within what is known as the Richmond District in the City and County of San Francisco, State of California, at the point where Eleventh avenue intersects Fulton street; thence northerly along Eleventh avenue to A street; thence westerly along A street to Twenty-third avenue; thence southerly along Twenty-third avenue to C street; thence westerly along C street to Forty-eighth avenue; thence in a southerly direction crossing the westerly end of Golden Gate Park in said City and County, intersecting the main line hereinbefore described at some convenient point on the westerly side of a tract of land known as the Rancho Laguna de la Merced, and also connecting the last above described line by a like railroad commencing at the intersection of said Eleventh avenue and C street; thence

westerly along C street to where the same intersects the line last above mentioned on Twenty-third avenue in said City and County of San Francisco, State of California ;

Also all warehouses, railroads and railroad lines now owned by said Ocean Shore Railway Company, and all appurtenances to any and all said warehouses, railroads and railroad lines and branches, including therein all rights of way, roadways, tracks, side-tracks, turnouts, sidings, branches, rails, switches, depots, station houses, shops, warehouses, car houses, engine houses, power houses, machine shops, repair shops, buildings, erections and structures, super-structures, bridges, rolling stock, cars, motor cars, trailers, equipment, machinery, dynamos, poles, wires, electrical and mechanical appliances, fixtures, furniture, tools and implements, now owned by the said Ocean Shore Railroad Company ;

And also all the franchises, rights of way, leases, licenses, consents, easements, rights, privileges and immunities relating or appertaining to said railroads or railroad lines and branches, or otherwise, and any and all extensions thereof or additions thereto, and all replacements or renewals of the same, or any part thereof, and all like property and estate which the said Ocean Shore Railway Company now possesses, owns or is entitled to ;

And also all the estates, grants, rights, title, interest, possession, claim and demand whatsoever, as well in law as in equity, of the said Ocean Shore Railway Company of, in and to the said property and premises, and every part and parcel thereof, with the ap-

purtenances thereunto belonging;

And any and all bonds and shares of stock of any other corporation or corporations now owned by said Ocean Shore Railway Company;

And also all other property, whether real, personal or mixed, belonging to the said Ocean Shore Railway Company and wheresoever situated;

Together with all and singular the tenements, hereditaments and appurtenances thereunto belonging and appertaining, [71] or at any time held or enjoyed therewith by the said Ocean Shore Railway Company, and the reversion and reversions, remainder and remainders, rents, tolls, incomes, issues and profits, thereof, with all the right, title, interest, estate, property, possession, claim and demand whatsoever, as well in law as in equity, of the said Ocean Shore Railway Company, of, in and to the same, or any part or parcel thereof.

TERMS OF SALE:

(1) Such sale shall be made for cash, in gold coin of the United States of the present standard of weight and fineness.

(2) There shall be paid to said Mercantile Trust Company of San Francisco, on the fall of the hammer, in cash the sum of one hundred and thirty-one thousand four hundred and thirty-three and 59-100 dollars (\$131,433.59).

(3) The payment of the balance of the purchase price shall be made within forty-five (45) days after the date of said sale, and upon the execution and delivery by said Mercantile Trust Company of San Francisco to the purchaser or purchasers, his or their

successors or assigns, of the proper instruments of conveyance.

(4) No bid will be received or accepted for said properties for a less sum than one million dollars (\$1,000,000).

(5) Such sale and the transfer and conveyance of said properties will be made subject to the payment of the several claims against said Ocean Shore Railway Company, which shall hereafter be determined by a final judgment or decree of a court of competent jurisdiction, to be entitled to priority of payment over the bonds in said deed of trust described, the amount of which said claims said Circuit Court of the United States has estimated, for the purpose of advising the purchaser at said sale, will not exceed in the approximate aggregate the total sum of one hundred thousand dollars (\$100,000.00); and subject, also, to the right of any purchaser or purchasers, his or their successors or assigns, to deposit with the Clerk of said Court, first mortgage sinking-fund gold bonds of the face or par value of two hundred thousand (\$200,000.00) dollars in substitution for the lien of said claims, which said bonds shall form a part of an issue not exceeding four million (\$4,000,000.00) dollars and bearing interest at not less than five (5) per cent per annum, the payment of which shall have been secured by a first mortgage on the right, title and interest acquired by the purchaser in and to all of the properties hereinbefore described of said Ocean Shore Railway Company; and upon the payment of such claim, or the deposit with the Clerk of this Court of such bonds, as aforesaid, the

said property will be released from the liens of said claims; and which said bonds are to be held by said Clerk as security for the payment of such claims, or any of them, as shall be determined and adjudged by said Court, by final judgment or order to be entitled to such priority of payment, and as may be ordered to be paid by said Court, prior to the payment of the bonds now issued and outstanding under said deed of trust, as in said order more fully appears.

(6) The purchaser or purchasers at such sale, for the purpose of making settlement or payment of so much of the purchase price of the property purchased as shall remain unpaid after the payment of the cash required to be paid upon the fall of the hammer, shall be entitled to turn in to Mercantile Trust Company of San Francisco, and to have applied toward the said balance of the purchase price, and shall be entitled to be credited with bonds issued and outstanding under said deed of trust, the payment of which is secured thereby, and any matured and unpaid coupons, and interest upon any bonds so issued and outstanding; and said bonds and coupons will be received and credited upon such purchase price for such an amount as shall be equal to the distributive share, which the holders of each of such bonds and coupons shall be entitled to receive out of the net proceeds of such sale, after making the deductions allowed by law; provided, that if it shall appear that any of said bonds and coupons have been pledged by said Ocean Shore Railway Company, and are at the date of said sale so held in pledge to secure

the payment of any sum of money due or owing by said Ocean Shore Railway Company, the amount for which said pledged bonds and coupons will be so received and applied, will be the amount of the obligation which they are so pledged to secure, or, if the amount of such obligation is, equal to, or in excess of the distributive share of all bonds, then only to the amount of such distributive share, and the bonds so surrendered and applied in payment of such purchase price, shall thereupon be deemed to be paid only to the extent to which they may be so applied.

(7) And such sale is made subject to the terms and conditions of that certain order of the United States Circuit Court, dated the 17th day of September, 1910, hereinbefore referred to, to which said order intending bidders or purchasers at said sale are hereby expressly referred for further particulars.

Dated San Francisco, September 19th, 1910.

[Seal] **MERCANTILE TRUST COMPANY
OF SAN FRANCISCO,**

Trustee.

JOHN D. McKEE,

Vice-President.

O. ELLINGHOUSE,

Secretary. [72]

9. AND IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said petition of said receiver, insofar as the same would interfere with or prevent the action of Mercantile Trust Company of San Francisco, in proceeding with the sale

and disposition of said properties, as trustee, be, and the same is hereby, denied, and that the cross-petition of said Mercantile Trust Company of San Francisco, subject to the terms and conditions of this order, be, and the same is hereby granted.

Dated San Francisco, Cal., September 17, 1910.

WM. C. VAN FLEET,

Judge. [73]

**Exhibit "E" [to Agreed Statement—Opinion on
Exceptions to Master's Report].**

*In the District Court of the United States, Northern
District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS, a Corpora-
tion,

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY, a Corpo-
ration,

Defendant.

The COURT (Orally):

I have asked counsel in the case of Baldwin Locomotive Works vs. Ocean Shore Railway to be here this morning that I might announce my conclusions based upon the exceptions to the Master's report filed in that case. The case has been under advisement for some time; it comprises an exceedingly voluminous record, a vast amount of brief matter and in fact a great deal of important subject matter for consideration.

I have been devoting for several weeks all the

spare time that I could give to a consideration of the large number of claims involved in the exceptions, and having reached conclusions satisfactory to myself, I have, in view of the obvious desirability of an early decision determined to announce my conclusions without awaiting the opportunity to submit them in writing. I am the more led to do this because of the fact that I find myself entirely in harmony and accord with the report of the Master with a single exception; in fact, I cannot [74] speak too highly of the character of the Master's work in this case. The controversy, as I have intimated, and as is known to all those concerned, was an exceedingly important one, and involved a large number of claims sought to be given preference over the mortgage debt by reason of asserted equities, and involved an immense amount of work so far as the Master's office was concerned. I cannot readily conceive that the case could have been handled in a more intelligent and thorough way than it has been by the Master as exhibited in his report. He has not only filed a report covering in detail all the subjects submitted to him, but he has accompanied it by a very exhaustive opinion wherein he has considered and analyzed all the leading cases bearing upon the one question which has given occasion in my mind for a difference as to my conclusion from that reached by him.

I do not purpose to specify or discuss any of the claims involved but the single class to which I shall hereafter direct your attention, for the reason, as I say, that I am in all other respects entirely satisfied

with the conclusions reported by the Master; and therefore because a claim is not specially mentioned by me, counsel will not indulge the idea that it has not received thorough consideration at my hands. I have not confined myself to the argument made before me. I have gone through the report of the Master, his opinion, and likewise all the leading briefs that were filed before him, and as a result it has left in my mind nothing calling for comment beyond what is to be found in the Master's report. He takes up and considers thoroughly and in detail, in all their bearings, the various questions that were referred to him, and with his conclusions I am, as stated, wholly satisfied with [75] the single exception that I am about to mention. That is the question—which it appears was made the leading one before the Master—as to the proper theory upon which priorities claimed by laborers during the six months period prior to the appointment of the Receiver, and claimants for necessary materials for keeping the road a going concern during that period, are to be allowed.

The Master has reached a conclusion, briefly stated, that the question of priorities for such claims depends entirely upon the question of diversion, that is, diversion of the current income fund; and he has held that neither laborers' claims nor the claims of materialmen can be allowed preference over the rights of the bondholders except in an instance where it appears that there has been such diversion used for the benefit of the mortgagees in some way that has resulted to their substantial benefit; in

other words, that if the current income which is to be looked to and treated as a trust fund for the payment of current expenses, has been diverted to the payment of interest on the mortgage debt, or for other purpose which has gone to the benefit of the corpus and resulting in a substantial betterment of the property, then the claims of laborers and materialmen may be given priority to the extent of such diversion; but not otherwise.

I am inclined to think, from a consideration of the cases which the Master has so ably analyzed bearing upon that subject, that perhaps from a strictly logical point of view, based upon the course of reasoning there followed, there is strong support for his conclusions. But unfortunately for that view the courts have not given it practical application; [76] they have in fact in every instance thus far occurring, where the question has come up, allowed for one reason or another priority to laborers' claims that had been incurred for the essential purpose of keeping the road in operation; and it appears that in this circuit that principle has in several cases been distinctly announced and affirmed by the Circuit Court of Appeals. That Court has held that in such instances the requirement of keeping the road a going concern is one which is paramount to the consideration whether or not there has been a diversion; evidently proceeding upon the theory that in the maintenance of this character of property it is so absolutely essential as lending it value to keep it in operation that they will allow as a preference claims which grow out of the work of laborers and

that class of materials which in their essential nature go to maintain the operation of the road, such as fuel-oil, coal, lubricating oils, and water for steam and other essential purposes, notwithstanding it appear that there is in the particular instance no diversion of the current fund shown.

Now, the Master, giving due consideration from his point of view to this class of cases has nevertheless reached a conclusion that the principles there followed are necessarily overruled in the most recent case from the Supreme Court of *Gregg vs. Metropolitan Trust Company*, in the 197 U. S., an opinion written by Mr. Justice Holmes. I have given that case very careful consideration, and while the reasoning of the Court is such as to lend considerable weight to the views of the Master as deduced therefrom, I am nevertheless not satisfied that the case so clearly contravenes the doctrine [77] that has been established in this Circuit that I would be at liberty to assume that it necessarily overrules it. Of course it is well established that this Court is bound to follow the principles enunciated by the Circuit Court of Appeals of its circuit unless it is enabled to see clearly that those principles have been unquestionably overturned by later decisions of the highest tribunal. While Judge Holmes in *Gregg vs. Metropolitan Trust Company* bases his conclusion upon considerations which, as I say, may be regarded as lending strong color to the views of the Master, he nevertheless makes use of references to previous decisions allowing laborers' claims, in a manner to indicate that he apparently regards the latter as not

being fully within the principles he is there applying. I am unable, therefore, to reach the conclusion that the rule established in this Circuit has been distinctly overturned by that decision, and that being so I am forced to the conclusion that the result reached by the Master must be overruled in that one particular.

The Master went into a very thorough investigation as to the amount of diversion in this case and reached a conclusion that it was less in amount than the sum of all the claims falling within the class entitled to preference, and concluded accordingly that the latter could only be allowed for a pro rata which would bring them within the amount of diversion shown. My conclusion is that they must be paid in full without reference to the amount of diversion; and that they must be held to be a lien upon the proceeds of the property prior to that of the mortgagees. This will apply of course only as to laborers' claims accruing within the six months, and such claims for material furnished during that [78] period as come within the class that are absolutely essential to the maintenance of the road as a going concern,—the character of which I have heretofore enumerated. The two classes cannot be distinguished in principle.

In all other respects the exceptions to the Master's report will be overruled.

I think from my review of the report that the facts found by the Master are sufficient upon which to base a decree in accordance with the conclusion I have reached without a further reference. That,

however, is a matter which may be found to be true or not. The parties may proceed—and I would suggest that it be done in conjunction with the Master—to draft a proper decree. If it shall be found that the facts contained in the Master's report are not sufficient to clearly enable the Court to enter a final decree without a further reference of the question, such further reference may be had.

I had hoped to be able when I found that I was reaching a conclusion upon this question at variance with the Master, that in deference to his very elaborate discussion of it, I should find the opportunity to put my views in writing; but the situation of my calendar is such that I have been unable to do so, and under the circumstances that I have heretofore indicated, that is, the large number of people who are interested in this result, I have deemed it better to announce my conclusion briefly and generally and thus permit the parties to have an opportunity, if they shall be so advised, to take the question involved to the Circuit Court of Appeals and have it determined there.

When a decree is prepared in accordance with the suggestions made, it may be presented. [79]

[Endorsed]: Filed Dec. 16, 1913. W. B. Maling, Clerk. By J. A. Schaertzer, Deputy Clerk. [80]

*In the District Court of the United States for the
Northern District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,

Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,

Respondent.

H. D. PILLSBURY et al.,

Intervenors.

Decree Confirming Master's Report on Debts Accruing Prior to the Appointment of the Receiver and During the Receivership.

The United States Circuit Court for the Ninth Judicial Circuit and the Northern District of California, predecessor of the above-entitled court, by its six separate orders given and made in the above-entitled proceeding on July 28, 1910, September 29, 1910, March 13, 1911, March 20, 1911, May 15, 1911, and June 27, 1911, appointed Honorable H. M. Wright, formerly standing Master in Chancery of the United States Circuit Court for the Ninth Judicial Circuit and the Northern District of California, and now standing Master in Chancery of the above-entitled court, to take [81] evidence upon, determine and report to said Court the indebtedness of said Ocean Shore Railway Company, and whether general or preferred, and the relative priorities of the various debts as between the various creditors

of the Ocean Shore Railway Company and as against the lien created by the bond issue of said Ocean Shore Railway Company; and said Master having filed herein, in pursuance of said orders, a report on debts accruing prior to the appointment of the Receiver herein and a report on debts accruing during said receivership, to the effect substantially as follows:

(a) The debts entitled to preference over the bonds were the current and ordinary debts of normal operation and maintenance, ordinarily and by reasonable expectation payable out of the current income from such operation, and accruing between June 1, 1909, and the date of the Receiver's appointment, December 6, 1909.

(b) Such preference in payment was conditioned upon and limited in amount by the existence of a fund composed (1) of current income on hand at the Receiver's appointment, (2) of net income of the Receiver's operation, and (3) of the amount of current income of operation between June 1, 1909, and December 6, 1909, which was diverted from the payment of current and ordinary operating expenses to other purposes.

(c) That the amount of said preferred claims, set forth in detail, was \$48,571.42, and that the same were payable out of the proceeds of sale, *pro rata* only, to the extent of such diversion, viz., \$30,000.00, there being in fact no income on hand at the beginning of the receivership and no net income during the receivership. [82]

(d) That the Receiver's debts for keeping the

railroad a going concern were payable, irrespective of any such diversion, in advance of the bonds, and were a prior charge on the proceeds of sale; and that the only such debt unpaid, covering the period of the receivership, was one to the Charles A. Warren Co. for passenger-car rentals in the sum of \$2,487.30.

(e) That claims upon notes issued or ordered issued by the Receiver under the Court's order finding that their execution was necessary to keep the road running, were likewise preferred claims, irrespective of any diversion of current funds; said claims covering land rentals prior to the receivership in various amounts to various persons, and aggregating \$5,943.78, with interest.

(f) That all other claims were general debts, without preference over the bonds.

And various claimants having duly filed herein their exceptions to said reports, and said reports and said exceptions thereto coming on regularly for hearing in this court, and the matter having been duly presented and argued by the parties interested, was duly submitted to the Court for its consideration and decision; and the Court having duly considered the same did on the 20th day of January, 1913, render its decision confirming said reports in all respects as presented and filed, except in so far as the Master found that said claims aggregating in amount \$48,571.42 were payable *pro rata* only, to the extent of said amount of diverted earnings, viz., \$30,000.00, the Court considering that said claims were payable in full, in preference to the bonds, irrespective of diversion or the amount thereof, as to which claims

[83] the exceptions of claimants were sustained; and that said claims, aggregating \$48,571.42, \$2,487.30 and \$5,943.78 are entitled to priority as against the purchasers of said Ocean Shore Railway Company, to wit, C. C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and A. C. Kains, to the full amount of their several claims, and that said claims and each of them, to the extent that they have been found to be preferential, are proper charges against said bondholders and purchasers and against the property of said Ocean Shore Railway Company, and that said preferred claims and each of them should constitute a lien upon the property of said Ocean Shore Railway Company in the hands of the purchasers, sold in accordance with the order of sale heretofore made herein; and it appearing that out of the proceeds of sale, deposited by the purchasers of said railroad, a balance remains in the hands of the Mercantile Trust Company of San Francisco, a corporation, and in the hands of the Receiver of this court, F. S. Stratton, available for payment of debts herein declared payable;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the said reports of the said Master be and the same are hereby confirmed in all respects as presented and filed, except as to the finding and conclusion therein contained that certain claims accruing between June 1, 1909, and December 6, 1909, the date of the appointment of the Receiver, found to be preferential in character, are entitled to payment only to the extent to which current earnings of that period have been

diverted from the payment [84] of current obligations of that period, viz., \$30,000.00; as to such preferential claims, the exceptions of said claimants are sustained, and said claims must be paid in full to the extent and in the amount that they are found to be preferential, irrespective of the question of the diversion of current funds, and are entitled to priority as against the bondholders and purchasers of said Ocean Shore Railway Company, and their successor or successors or assigns, to the full amount of the claims. Said claims, and each of them, together with interest at the rate of 7 per cent per annum from the date of the filing of this decree, are hereby made a lien upon all properties of said Ocean Shore Railway Company sold by the Trustee under said deed of trust in pursuance of said order of sale as aforesaid. Said lien hereby imposed constitutes a first lien on all said properties and takes precedence of all liens that may have heretofore attached to said properties or any part thereof, and the claims secured thereby must be paid in preference to any and all claims arising under the deed of trust hereinbefore referred to.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that if any of the claims referred to in the last paragraph hereof shall not be paid by the purchasers C. C. Moore, F. W. Bradley, R. D. Robbins, Maurice Schweitzer and A. C. Kains, or their successors, within thirty (30) days from the date of the filing of this decree, the standing master of this court, upon written request of the solicitor of any such claimant, shall forthwith cause to be

sold, in accordance with law in such cases made and provided, and in accordance with the further order of this court, if any, all of the properties subject to said lien, for the purpose of [85] satisfying and discharging said lien, and the said Master is hereby vested with all the power and authority necessary to conduct and consummate said sale, subject to confirmation by the Court. Out of the proceeds thereof, the Master shall pay and discharge:

1st. The expenses of said sale, including the Master's fees and the costs of the proceedings in connection therewith, to be settled by the Court on confirmation thereof;

2d. All of said preferred claims with accrued interest and costs;

3d. The residue, if any, to be paid to said purchasers of the properties of said Ocean Shore Railway Company, hereinbefore referred to, or their successor or successors or assigns; provided, however, that in any event, said properties shall not be sold for less than the sum of One Hundred Thousand Dollars (\$100,000), and provided further that said purchasers, or their successor or successors or assigns may discharge said lien by paying to or depositing with the Clerk of this Court, for the benefit of the beneficiaries of said lien, in gold coin of the United States of America, an amount sufficient to pay in full all of the claims secured thereby, together with interest thereon at the rate of seven per cent per annum from the date of this decree, and costs. If the sums of money so deposited with the Clerk be not claimed by said beneficiaries within two years from

the date when this decree becomes final, then said sums, less Clerk's fees, shall be returned to the persons or corporations making such deposit, their successors or assign. No bonds of said Ocean Shore Railway Company, or its successor or successors or assigns, may be deposited in lieu of said money, as the option so to do, given by said order of sale of September 17th, 1910, has lapsed. [86]

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Mercantile Trust Company of San Francisco, a corporation, or its successor, do forthwith pay to the following persons, firms or corporations, out of the fund provided therefor by the order of sale hereinbefore referred to, the amounts set after their respective names as follows:

Trustee of the estate of C. O'Connor, deceased, \$1298.39, with simple interest at 7% from April 21, 1910;

Gertrude H. Collins, \$3277.42, with simple interest at 7% from January 24, 1910;

Patrick Moloney, \$547.65, with simple interest at 7% from May 31, 1910;

Boyce Lumber Co. and E. J. Boyce, \$14.51, with simple interest at 7% from February 7, 1910;

E. J. Boyce, Boyce Lumber Co., and Mary E. Bates, \$29.03, with simple interest at 7% from February 7, 1910;

E. J. Boyce, \$9.68, with simple interest at 7% from February 7, 1910;

Michael Clark, \$767.10, without interest.

Provided, further, however, that if said fund is

not sufficient to pay said claims in full, said persons, firms or corporations shall have a lien upon all properties of said Ocean Shore Railway Company, sold by the Trustee under said deed of trust in pursuance of said order of sale, or of the orders amendatory thereof, to secure payment to them of any balance thereon remaining unpaid, said lien to be similar in all respects to the lien hereinbefore imposed for the benefit of preferred claimants.

And it is further ordered that Mercantile Trust Company of San Francisco, after making payment to the respective parties hereinabove named, and to Charles A. Warren Company (if, pursuant to this order, it shall be required to make such payment to Chas. A. Warren Co.) of the said amounts out of the funds so remaining in its hands, if sufficient for that purpose, do further pay to Charles C. Moore, F. W. Bradley, R. D. Robbins, Maurice Schweitzer and A. C. Kains, or their successors or assigns, any [87] balance remaining on deposit with said Mercantile Trust Company of San Francisco of said fund provided for by the order of sale hereinbefore referred to, and this order shall constitute its authority so to do;

And it is further ordered that, upon said payments being made as aforesaid, said Mercantile Trust Company of San Francisco shall stand acquitted and discharged from all further obligations to administer said fund, or to act therefor, and from all trusts created therein.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED, that the Receiver of said Ocean

Shore Railway Company do forthwith pay to Charles A. Warren Company, a corporation, the sum of \$2487.30, without interest, out of any funds in his hands as such Receiver available for that purpose, but in the event that he has no such fund, or that such fund is insufficient to pay said claim in full, then said Mercantile Trust Company of San Francisco, a corporation, or its successor, shall forthwith pay to said Charles A. Warren Company, a corporation, out of the fund hereinabove referred to, the amount thereof remaining unpaid by said receiver; provided, however, that if said funds are insufficient to pay said claim in full, said Charles A. Warren Company shall have a lien on all of the property of said Ocean Shore Railway Company sold as aforesaid, to secure payment to it of any balance thereon remaining unpaid, said lien to be similar in all respects to the lien hereinbefore imposed for the benefit of preferred claimants.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the following persons and firms, as solicitors for various claimants herein, are entitled to the payment of the sums set opposite their respective names as costs herein, with interest thereon from the date of the filing of this decree, at the rate of 7 per cent per annum; and the payment of said sums, together with interest, is hereby secured by the lien hereinbefore referred to. [88]

Name.	Amounts.
Gibson & Woolner.....	\$ 6.50
R. P. Ashe.....	14.40
I. S. Chapman.....	2.80

Name.	Amounts.
Williamson & Dibblee.....	1.50
Christie, Walter	5.00
O'Donnell	3.40
L. T. Jacks.....	7.00
W. B. Bosley & Leo H. Sussmann.....	10.20
C. A. Strong.....	3.00
T. E. Vanomen.....	2.00
F. M. Hultman.....	6.80
J. P. Langhorne & Richard Bayne.....	25.80
R. S. Norman.....	4.60
L. T. Hengstler	1.40
Charles J. Heggerty.....	17.60
Cushing & Cushing.....	1.60
J. R. Pringle.....	2.60
W. H. Barrows	15.60
J. C. Campbell.....	5.00
Wm. C. Knox.....	10.70
Othello C. Pratt.....	2.60
Weinmann, Wood & Cunha.....	4.20
W. C. Graves.....	2.00
S. C. Wright.....	2.40
C. E. Lindsay.....	31.75
Neal Power	2.00
William A. Nunlist.....	3.00
Kennedy & Kirk.....	7.50
Marshall Nuckolls	8.00
John O. McElroy.....	69.62
M. R. Carey.....	107.20
Sullivan & Sullivan and Theo. J. Roche....	142.00
Goodfellow, Eells & Orrick.....	212.20
H. M. Wright (Master).....	28.86

(For costs awarded to W. T. Hume, S. S. Wright, D. E. Besecker & King, J. F. Giblin and W. A. Allen and unpaid to the Master.)

And it further appearing that on the 24th day of April, 1912, the above-entitled court in the above-entitled matter duly gave and made its order directing payment to John F. Forbes of the sum of \$850.00 for services rendered for [89] the common benefit of the claimants hereinafter set forth, payable by said claimants *pro rata*, out of any moneys they may receive herein;

NOW, THEREFORE, IT IS HEREBY ORDERED that, out of the fund referred to, there shall be paid to John F. Forbes the sum of eight hundred and fifty (850) dollars, with interest thereon at the rate of 7 per cent per annum from the date of the filing of this decree, and the said amount shall be deducted *pro rata* from the amounts due the holders of preferred claims, as hereinafter set forth.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this court retain and reserve full jurisdiction, beyond the term of court at which this decree is made, and as long as necessary, for the purpose of enforcing each and every provision of this decree, and shall not be divested of jurisdiction until all the matters herein provided for shall have been completely determined and disposed of, and the present term is extended until this decree shall be fully performed.

In the first column of the following tabulation are the names of the claimants hereinbefore referred to

as having preferred claims, except those hereinbefore specifically set forth; in the second column are the amounts of the said preferred claims; and in the third column the amounts which they are entitled to receive, together with interest thereon from the date of the filing of this decree, at the rate of seven per cent (7%) per annum, after deducting the *pro rata* of \$850.00 above referred to. [90]

Name.	Amount of Preferred Claim.	Amounts to be Paid.
Dr. J. C. Spencer.....	\$ 157.50	\$ 154.74
E. Moulty	80.11	78.71
F. G. Barclay.....	59.18	58.14
Charles Butler	159.70	156.90
M. J. Howe	114.41	112.40
P. Long	374.46	367.90
D. J. McGowan.....	147.52	144.94
M. J. McGuire	393.27	386.38
Jas. Mills	96.36	94.67
Timothy O'Driscoll	110.30	108.37
Thos J. O'Keefe.....	148.70	146.09
C. O. Reeves	208.35	204.70
M. R. Twomey	268.97	264.26
Thomas H. Williams	242.11	237.87
Michael Albrecht	368.87	362.41
John Fitzpatrick	60.87	59.80
Patrick Galvin	258.80	254.27
Thomas E. Hanley.....	235.75	231.62
J. W. Manning	312.11	306.65
John Hurley	147.41	144.83
B. T. or B. F. Cowgill.....	84.44	82.96
Wm. A. Stoll	274.15	269.35
Peter White	290.35	285.24

Name.	Amount of Preferred Claim.	Amounts to be Paid.
Mary Knights	\$ 91.41	\$ 89.81
Colita Chatard	50.61	49.72
Clara Ferini	26.74	26.24
W. P. Geary	322.69	317.04
John Noriega	173.92	170.87
E. L. Smith.....	76.58	75.24
J. H. Hurlbut	496.87	488.17
W. J. Berger	349.63	343.50
[91]		
Charles Colson	49.00	48.14
Dr. Albert B. McKee.....	22.00	21.61
Drs. Phillips and Phillips....	124.50	122.31
Louis Irons	150.15	147.52
Chas. W. Baker.....	637.50	626.34
Wm. Otterson	202.80	199.25
K. O. Whitson	276.26	271.50
H. P. Thomas	98.55	96.82
E. P. Lenox	55.05	54.08
Dr. W. A. Brooks or Brooke..	12.50	12.28
Clara Greene	53.84	52.89
L. C. Greene	186.52	183.50
Francis M. Sellers	299.74	294.49
D. H. or E. H. Danmann.....	44.00	43.23
A. L. Geggus	212.03	208.32
J. W. Crosby	241.55	237.32
J. M. Gilbert	82.52	81.07
P. P. Chatard	81.28	79.85
H. V. Rippon	94.78	93.12
Carl Sager	75.92	74.59
Metta E. Stross	83.11	81.65
C. N. Compton	149.85	147.22

Name.	Amount of Preferred Claim.	Amounts to be Paid.
Louis Zachert	\$ 59.58	\$ 58.53
Gus D. Hurlbut	199.77	196.27
Frank L. Sawyer	168.42	165.47
F. L. Donahoo	210.38	206.70
L. T. Coates	224.12	220.19
H. L. Staples	296.29	291.10
Mrs. J. E. Shilladey.....	262.79	258.19
C. E. Bass	224.41	220.48
J. L. Whissen	167.93	164.99
[92]		
H. L. Goodloe.....	264.62	259.99
R. J. Ellis.....	119.96	117.86
Oliver W. Hall.....	88.68	87.13
E. G. Gray.....	115.84	113.81
S. K. Woodburn.....	141.90	139.41
Fred L. Sparks.....	249.29	245.27
O. J. Effenbeck.....	176.84	173.74
J. A. Roix.....	272.18	267.41
W. N. Silsby.....	116.95	114.90
W. D. Wilcox.....	5.22	5.13
F. A. Stoekel.....	222.05	218.16
Wm. A. Roix.....	322.75	317.10
J. Matthews	295.50	290.33
J. W. Gray.....	53.73	52.29
F. H. Sage.....	260.95	256.38
Oscar S. Westberg.....	164.30	161.42
R. P. Standley.....	201.30	197.77
W. B. Scott.....	198.02	194.55
H. Horn.....	184.60	181.37
C. Becker.....	478.93	470.55
George W. Agnew.....	54.89	53.93

Name.	Amount of Preferred Claim.	Amounts to be Paid.
D. W. Bale	\$ 173.84	\$170.79
J. W. Carter.....	14.52	14.27
C. Conto.....	267.80	263.11
L. Lucas or Lukas.....	86.24	84.73
F. J. Lyons.....	243.29	239.03
John J. Dake.....	318.63	313.05
Henry Rosenblad or Rosenblatt	134.86	132.50
Daniel Keith	138.25	135.83
W. M. Boeken.....	17.75	17.44
W. M. Boeken.....	52.50	51.58
[93]		
M. H. Lawson.....	112.55	110.58
John Kennedy.....	18.26	17.94
Xavier Pasqualine.....	105.25	103.41
C. E. Twisselman.....	288.75	283.69
E. B. Shilladey.....	341.12	335.15
Fred Helin	46.65	45.83
D. R. Parsley.....	54.55	53.59
S. George	34.48	33.87
M. Moeller.....	15.00	14.74
E. L. Braswell.....	577.06	566.96
M. Moeller.....	10.00	9.82
“ “	15.00	14.74
“ “	12.25	12.03
S. F. Dart.....	218.58	214.75
A. Poulos.....	121.26	119.13
John Conto	181.34	178.16
J. Verigachis.....	43.52	42.76
Mary J. Hanley.....	112.00	110.04
E. T. Charlton.....	718.30	705.73
Charles T. Faucett.....	195.92	192.48

Name.	Amount of Preferred Claim.	Amounts to be Paid.
Patrick Cavanaugh.....	\$ 169.12	\$166.16
C. E. Wilcox.....	332.05	326.24
Chris Economou or Conomu..	104.19	102.36
Gus Kostakis.	120.09	117.99
F. Legourious.....	40.00	39.30
N. Spiros	51.94	51.03
Mike Popovitz.....	10.55	10.36
P. Judas	10.55	10.36
C. Pappas	13.10	12.87
John Kenny.....	79.89	78.49
Chas. E. Croly.....	107.10	105.22
J. G. James Co.....	285.10	280.11
[94]		
W. H. Frye.....	69.50	68.28
Wm. C. Knox	118.30	116.23
Chas. H. Wilson.....	156.75	154.00
C. B. Johnson.....	174.27	171.22
James Rosar....	226.25	222.29
A. E. Siebel or Siegel.....	161.52	158.69
J. Gergusiakis ..	35.96	35.33
P. Drulis....	76.36	75.02
Louis Lait.....	94.50	92.84
T. E. Vanomen....	62.00	60.91
Aug. Johnson..	37.95	37.28
C. Pappas.....	109.95	108.02
Dr. A. S. Keenan.....	25.00	24.56
P. O'Farrell.....	29.90	29.37
J. F. Giblin.....	226.23	222.27
D. E. Besecker.....	210.75	207.06
Sidney Sprout	157.68	154.92
Smith Emery Co.	12.00	11.79

Name.	Amount of Preferred Claim.	Amounts to be Paid.
Fairbanks Morse & Co.....	\$ 216.62	\$257.04
J. Homer Fritch, Inc.....	344.37	338.34
W. L. Holman Co.....	97.15	95.45
Remington Typewriter Co...	47.23	46.40
Acme Lumber Co.....	313.82	308.32
E. W. Thomas Oil Burner Co.	150.00	147.37
Western Building Material Co.	162.64	159.79
San Francisco Gas and Elec- tric Co.	2955.31	2903.59
Southern Pacific Co.	566.73	556.81
Postal Telegraph Cable Co...	178.31	175.19
Westinghouse Airbrake Co...	361.24	354.92
Westinghouse Traction Brake Co.	617.85	607.03
[95]		
Simplex Ry. Appliance Co...	42.00	41.26
F. A. Hihn Co.....	387.10	380.32
E. L. Smith.....	20.00	19.65
Australian Hardwood Co... ..	36.75	36.10
California Litho. Co.....	24.00	23.58
A. Carlisle & Co.....	1010.40	992.71
S. F. Call	914.64	898.63
Dow Pump Eng. Co.	150.00	147.37
Eccles & Smith Co... ..	42.05	41.31
John Finn Metal Works	130.77	128.48
General Electric Co.....	689.25	677.19
Gallagher & Motts	90.00	88.42
Great Western Smelting & Refining Co.....	94.60	92.98
Holmes Lime Co.....	26.80	26.33

Name.	Amount of Preferred Claim.	Amounts to be Paid.
G. M. Josselyn & Co.	\$ 323.82	\$318.15
L. Kingswell.....	155.53	152.81
Peck-Judah Co.....	10.00	9.82
J. A. Roebling's Sons Co.....	73.93	72.63
Squire & Byrne	176.13	173.04
Enterprise Foundry Co... ..	129.81	127.54
Pacific States Electric Co.....	38.96	38.28
White Brothers.....	292.58	287.46
Pinkerton's Nat'l. Detective Agency	93.00	91.37
S. K. Mitsuse.. ..	2143.29	2105.78
Knox Collection Agency, as- signee.....	100.00	98.25
F. O. Rood, assignee.....	71.25	70.00
C. P. Mosconi	163.94	161.07
J. Miller (assignee).....	202.91	199.36
S. Skliris.....	53.70	52.76
Dr. W. C. Hopper.....	63.50	62.39
Wm. A. Doyle.....	197.14	193.69
Helen W. Lee	276.04	271.23
[96]		
E. S. Reinoehl.....	138.03	135.61
A. S. Lozier.....	566.55	556.63
A. J. Ault.....	106.50	104.63
N. Papostolu	11.05	10.85
F. L. Berry.....	142.15	139.66
F. J. Bettinger	199.97	196.47
I. W. Fleming.. ..	300.69	295.49
J. S. Grow.. ..	248.60	244.25
Thomas Hewitt	79.55	78.15
L. Welch.....	219.66	215.80

Name.	Amount of Preferred Claim.	Amounts to be Paid.
A. Engelson	\$ 77.57	\$ 76.20
Thos. Day Co.	1.50	1.47
Ft. Pitt Spring Mfg. Co.	19.74	19.39
Gould Coupler Co.	90.00	88.42
Joost Bros.	10.15	9.97
Smith Copper Works.	85.99	84.48
Fred Ward & Son.	17.63	17.32
Coffin Redington & Co.	2.55	2.50
W. P. Fuller & Co.	500.07	491.32
Gorham Rubber Co.	215.70	211.92
Pacific Hardware & Steel Co.	575.06	565.00
Schwabacher Frey Stationery Co.	16.00	15.72
Selby Smelting & Lead Co. . .	1.66	1.63
Geo. H. Tay Co.	12.12	11.90
A. L. Young Mach. Co.	10.00	9.83
Zellerbach Paper Co.	38.18	37.51
Wm. H. Baxter	198.40	194.92
T. M. Daly	350.59	344.49
E. L. or G. L. Duncan.	145.45	142.90
H. P. Elliott.	152.95	150.27
C. W. Finch.	170.52	167.53
[97]		
M. E. Hale.	81.35	79.92
J. J. Higgins.	231.56	227.50
M. S. Kentzell.	95.61	93.93
Owen Larkin.	41.75	41.02
G. or J. Priola.	67.90	66.71
A. Schilling.	25.73	25.28
Ernest De Temple.	81.50	80.07
P. Nickolas	88.60	87.05

Name.	Amount of Preferred Claim.	Amounts to be Paid.
P. Paulis	\$ 137.85	\$135.43
J. Paulis.....	171.10	168.10
J. Kafolas.....	175.60	172.52
P. Milos.....	103.60	101.78
P. Kafolas.....	28.30	27.80
J. Pandaces	28.30	27.80
M. Panos..	23.90	23.48
M. Simon	41.03	40.31
A. Kiniafatos	55.70	54.72
N. Paris.....	144.35	141.82
S. L. Kampschmidt	46.24	45.43
F. F. Roake.....	44.90	44.11
George G. Smith.....	134.37	132.02
N. Louto.....	75.04	73.72
George Doody..	153.13	150.45
R. H. Shaves..	76.00	74.67
J. Markis.....	17.80	17.49
G. or J. Metzger	66.65	65.48
F. J. Reedy	135.13	132.76
L. & M. Alexander & Co.....	3.00	2.94
Santa Cruz Water Works.....	3.00	2.94
Spring Valley Water Co.....	1174.96	1154.40
F. L. Browne.....	249.90	245.52
Jas. Casper.....	128.38	126.13
H. H. McEwen.....	334.75	328.89
[98]		
Charles Jarvis	126.39	124.18
H. H. Jordan.....	290.35	285.27
J. L. Cunningham..	430.40	422.87
J. O. Frain.....	395.34	388.42
F. W. Cassidy.....	253.17	248.74

Name.	Amount of Preferred Claim.	Amounts to be Paid.
S. J. Murphy	103.26	101.45
Peter Johnson	216.90	213.10
J. H. McMurphy	308.04	302.65

Dated: July 18th, 1913.

WM. C. VAN FLEET,

Judge.

Approved as to form:

H. M. WRIGHT,

Master.

[Endorsed]: Filed and entered July 18, 1913. W. B. Maling, Clerk. By J. A. Schaertzer, Deputy Clerk. [99]

In the District Court of the United States, for the Northern District of California, Second Division.

IN EQUITY — No. 15,008.

BALDWIN LOCOMOTIVE WORKS,

Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,

Respondent.

CHARLES C. MOORE, F. W. BRADLEY, MAURICE SCHWEITZER, R. D. ROBBINS, WALTER S. MARTIN et al.,

Intervenors.

Summons and Severance [as to A. C. Kains].

To A. C. Kains:

YOU ARE HEREBY INVITED to join with the undersigned to prosecute an appeal in the above-

entitled cause from the United States District Court, Northern District of California, to the United States Circuit Court of Appeals, in and for the Ninth Judicial Circuit, to reverse the judgment and decree in the above-entitled cause given, made and rendered against you and the undersigned, on the 18th day of July, 1913, wherein and whereby it was ordered and decreed that the report of H. M. Wright, Standing Master in Chancery of the above-entitled court, on certain debts accruing prior to the appointment of a receiver herein, and on debts accruing during said receivership, be confirmed in all respects as presented and filed; except in certain particulars as will appear from said decree; or you will be deemed to have acquiesced in the said judgment and decree, and the undersigned [100] shall prosecute said appeal without joining you as a party.

CHARLES C. MOORE,
F. W. BRADLEY,
MAURICE SCHWEITZER,
R. D. ROBBINS,
WALTER S. MARTIN,
E. J. McCUTCHEN,
A. C. GREENE,

By McCUTCHEN, OLNEY & WILLARD,

Their Attorneys.

Due service and receipt of a copy of the above and foregoing is hereby admitted, this 11th day of August, 1913.

OLIVER B. WYMAN,
Solicitor for A. C. Kains.

[Endorsed]: Filed Aug. 15, 1913. W. B. Maling, Clerk. By J. A. Schaertzer, Deputy Clerk. [101]

In the District Court of the United States, for the Northern District of California, Second Division.

IN EQUITY—No. 15,008.

BALDWIN LOCOMOTIVE WORKS,

Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,

Respondent..

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROBBINS,
WALTER S. MARTIN et al.,

Intervenors.

Refusal [of A. C. Kains] to Join in Appeal.

Now comes A. C. Kains, and refuses to join with Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins, and Walter S. Martin in prosecuting an appeal from the United States District Court, for the Northern District of California, to the United States Circuit Court of Appeals, in and for the Ninth Judicial Circuit, as invited in a Summons and Severance heretofore and to-wit, on the 11th day of August, 1913, served on me, to reverse the judgment and decree in the above-entitled cause, given, made and rendered against the said Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D.

Robbins, Walter S. Martin and myself, on the 18th day of July, 1913.

A. C. KAINS,
By OLIVER B. WYMAN,
His Solicitor. [102]

Due service and receipt of a copy is hereby admitted, this 11th day of August, 1913.

McCUTCHEM, OLNEY & WILLARD,
Attorneys for Charles C. Moore et al.

[Endorsed]: Filed Aug. 15, 1913. W. B. Maling,
Clerk. By J. A. Schaertzer, Deputy Clerk. [103]

*In the District Court of the United States, for the
Northern District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,
Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,
Respondent.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROBBINS,
WALTER S. MARTIN et al.,
Intervenors.

Petition for Appeal.

Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, intervenors in the above-entitled action, conceiving themselves, and each of them conceiving himself, aggrieved by the decree and order made and entered in

the above-entitled cause in said court on the 18th day of July, 1913, wherein and whereby it was ordered and decreed that the reports of H. M. Wright, Standing Master in Chancery of the above-entitled court, on certain debts accruing prior to the appointment of the receiver herein, and on debts accruing during said receivership, be confirmed in all respects as presented and filed, except as to the finding and conclusion therein contained that certain claims accruing between June 1, 1909, and December 6, 1909, the date of the appointment of the receiver, found to be preferential in character, are entitled to payment only to the extent to which current earnings of that period were diverted to the payment [104] of the current obligations of that period, viz., thirty thousand dollars, as to such preferential claims, the exceptions of said claimants being sustained by the Court; and considering themselves, and each of them considering himself, aggrieved by the said decree wherein and whereby it was ordered and decreed that said claims must be paid in full to the extent and in the amount that they are found to be preferential, irrespective of the questions of the diversion of current funds, and that said claims are entitled to priority as against the bondholders and purchasers of said Ocean Shore Railway Company and their successor or successors or assigns to the full amount of the said claims, and that said claims, and each of them, should be made a lien upon all properties of said Ocean Shore Railway Company sold by the Trustee under said deed of trust, and that the said properties should be sold for the purpose of satisfy-

ing and discharging said lien, and having, on August 11, 1913, by a summons and severance on file in this court, invited and requested A. C. Kains to prosecute an appeal from said order and decree, and the said A. C. Kains on the same day having declined and refused, by a refusal likewise on file herein, to prosecute such an appeal,—do, and each of them does, appeal from said decree and order to the United States Circuit Court of Appeals, and they do, and each of them does, pray that this, their petition for said appeal, and for leave to prosecute said appeal as to their own interest severed from all interests of said A. C. Kains, may be allowed, and that a transcript of the record and proceedings and papers upon which said final decree, order and judgment was made, duly authenticated, may be sent to said United States Circuit Court of Appeals for the Ninth Circuit; and now, at the time of the filing of this petition for appeal, the said appellants file an assignment of errors, setting up separately and particularly each error asserted [105] and intended to be urged in the United States Circuit Court of Appeals for the Ninth Circuit.

Your petitioners further pray that an order be made fixing the amount of a supersedeas bond which these appellants shall give and furnish upon said appeal.

And your petitioners will ever pray.

EDWD. J. McCUTCHEN,
A. CRAWFORD GREENE,
McCUTCHEN, OLNEY & WILLARD and
GAVIN McNAB,

Solicitors for Charles C. Moore.

F. W. BRADLEY,
MAURICE SCHWEITZER,
R. D. ROBBINS and
WALTER S. MARTIN,

Intervenors.

[Endorsed]: Filed Aug. 15, 1913. W. B. Maling,
Clerk. By J. A. Schaertzer, Deputy Clerk. [106]

*In the District Court of the United States, for the
Northern District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,
Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,
Respondent.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROBBINS,
WALTER S. MARTIN et al.,

Intervenors.

Assignment of Errors.

Now comes Charles C. Moore, F. W. Bradley,
Maurice Schweitzer, R. D. Robbins and Walter S.

Martin, Intervenors in the above-entitled action, by their undersigned solicitors, and say that in the record, proceedings and decree entered in this cause on the 18th day of July, 1913, there is a manifest error, and that the said intervenors have been denied their just rights by the decree entered by said District Court, and the said intervenors hereby assign and set out separately and particularly the following errors, viz.:

I.

The Court erred in refusing to enter a decree that no one of the preferred claimants named in the decree entered by said Court on the 18th day of July, 1913, was entitled to the payment of his claim, or any part thereof, and that no one of said claimants was entitled to or had a lien upon the properties of Ocean Shore Railway Company sold by Mercantile Trust Company on January 17, 1911, prior to, or ahead of, [107] or superior to that of Mercantile Trust Company of San Francisco, and its successors in interest.

II.

The Court erred in entering its order and decree confirming the findings and report of H. M. Wright, Standing Master in Chancery of said court, in all respects as presented and filed, except as to the finding and conclusion therein contained that certain claims accruing between June 1, 1909, and December 6, 1909, found by the said Master to be preferential in character, are entitled to payment only to the extent to which current earnings of Ocean Shore Railway Company of that period were diverted from the payment of current obligations of said Ocean Shore

Railway Company of that period, and sustaining the objection of certain claimants as to said findings.

III.

The Court erred in entering its order and decree sustaining the objections of certain claimants as to the finding and conclusion of the said Master that certain claims accruing between June 1, 1909, and December 6, 1909, found by the said Master to be preferential in character are entitled to payment only to the extent to which current earnings of that period were diverted from the payment of current obligations of that period; and in ordering and decreeing that such claims must be paid in full, irrespective of the diversion of current funds by Ocean Shore Railway Company, and are entitled to priority as against the bondholders and purchasers of Ocean Shore Railway Company to the full extent of the claims, irrespective of the diversions by said Ocean Shore Railway Company of current operating income, and making such claims, and each of them, a first lien upon all properties of Ocean [108] Shore Railway Company sold by Mercantile Trust Company of San Francisco on January 17, 1911, and ordering that said claims must be paid in full in preference to all claims arising under said deed of trust.

IV.

The Court erred in entering its decree that the preferred claimants named in said decree, or any of them, are entitled to priority of payment as against the bondholders or purchasers, or the successor or successors in interest of either of them.

V.

The Court erred in entering its decree that the preferred claimants named in said decree, or any of them, are entitled to priority of payment as against the bondholders or purchasers, or the successor or successors in interest of either of them, to the full extent of the claims of said claimants.

VI.

The Court erred in entering its decree that the claims of claimants named in said decree must be paid in full, irrespective of the current income on hand when the receiver in the above-entitled action was appointed, and of the net income derived by said receiver from the operation of the said properties, and of the amount of current income of operation of Ocean Shore Railway Company between June 1, 1909, and December 6, 1909, which was diverted from the payment of current and ordinary operating expenses of Ocean Shore Railway Company to other purposes, and of the amount of current income of operation of Ocean Shore Railway Company between June 1, 1909, and December 6, 1909, which was devoted to the payment [109] of current and ordinary operation expenses.

VII.

The Court erred in making its order and decree that claims accruing between June 1, 1909, and December 6, 1909, in the sum of forty-eight thousand, five hundred seventy-one and 42/100 (48,571.42) dollars, were preferential in character and were prior charges against the property of Ocean Shore Railway Company sold by Mercantile Trust Company

of San Francisco on January 17, 1911, and that said claims constituted a first and prior lien upon said properties, when the Court, nevertheless, in making its said order, found and determined that there was no net income of Ocean Shore Railway Company on hand at the beginning of the receivership and no net income derived by the receiver during the receivership, and that the amount of current income of operation of said Ocean Shore Railway Company between June 1, 1909, and December 6, 1909, which was diverted from the payment of current and ordinary operating expenses of said Ocean Shore Railway Company to other purposes was not more than thirty thousand (30,000) dollars.

VIII.

The Court erred in making its order and decree that the claimants named in said decree were entitled to priority of payment and a first lien upon the properties of Ocean Shore Railway Company to secure said payment, although the receiver in the above-entitled action was appointed at the instance of parties other than Mercantile Trust Company of San Francisco, or its successors in interest.

IX.

The Court erred in sustaining the fourth exception of E. T. Charlton et al. to the conclusion of law of the Master, which said exception was as follows:
[110]

“That the Court erred in finding that claims, if otherwise preferential in character, could only be allowed to the extent of said sum of thirty thousand (30,000) dollars.”

X.

The Court erred in sustaining the fifth exception of E. T. Charlton et al., to the conclusion of law of the Master, which said exception was as follows:

“That error was committed in holding that the ultimate aggregate of allowances to unsecured claimants should be limited by the amount of diversion of income to the benefit of the bond-of priority.”

XI.

The Court erred in sustaining the sixth exception of E. T. Charlton et al., to the conclusion of law of the Master, which said exception was as follows:

“That error was committed in holding that proof of diversion is necessary to the allowance of priority.

XII.

The Court erred in sustaining the seventh exception of E. T. Charlton et al., to the conclusion of law of the Master, which said exception was as follows:

“That error was committed in holding that claims necessary to the business of the railroad should not be allowed priority except upon proof of diversion.”

XIII.

The Court erred in sustaining the eighth exception [111] of E. T. Charlton et al., to the conclusion of law of the Master, which said exception was as follows:

“That error was committed in holding that labor claims necessary to the business of the

railroad should not be allowed priority except upon proof of diversion.”

XIV.

The Court erred in sustaining the ninth exception of E. T. Charlton et al., to the conclusion of law of the Master, which said exception was as follows:

“That error was committed in holding that claims for supplies necessary to the business of the railroad should not be allowed priority except on proof of diversion.”

XV.

The Court erred in sustaining the tenth exception of E. T. Charlton et al., to the conclusion of law of the Master, which said exception was as follows:

“That error was committed in holding that operating claims which accrued within the six months’ period could only be allowed as a preferential indebtedness to the extent of the diversion shown.”

XVI.

The Court erred in not sustaining the exceptions, and each of them, filed by intervenors, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, to the findings and report of H. M. Wright, Master in Chancery of said Court. [112]

XVII.

The Court erred in not sustaining the fourth exception of said intervenors to the conclusion of law of the Master, which said exception was as follows:

“For that the Master has found (p. 26) that the principle, that a trustee must do equity in

order to get equity, has no necessary application in order to warrant the imposition of a lien on the *corpus* of the property or the proceeds of sale to the extent representing a diversion of income, prior to the appointment of a receiver; WHEREAS, the said Master should have found that the said principle is applied in all cases where priorities are claimed on account of services or materials furnished before the receiver is appointed; and that, unless a trustee asks the aid of a court of equity, he is not forced to do equity; and that, unless he petitions for a foreclosure and the appointment of a receiver, no prior liens can be allowed on account of materials supplied or labor furnished before the time at which the receiver is appointed."

XVIII.

The Court erred in not sustaining the seventh exception of said intervenors to the conclusion of law of the Master, which said exception was as follows:

"For that the said Master has found that the trustee did here seek the aid of a court of equity, WHEREAS, the Master should have found that the trustee did not seek the aid of a court of equity, [113] did not bring the action of foreclosure, did not secure the appointment of a receiver, or any other relief not its, as of right."

XIX.

The Court erred in not sustaining the eighth exception of said intervenors to the conclusion of law of the Master, which said exception was as follows:

"For that the said Master has found (p. 27)

that the filing of a cross-petition by the trustee and the granting thereof by the Court, the sale in pursuance of said petition, and the confirmation of said sale, constituted a coming into a court of equity sufficient to warrant the application of the equitable principle that he who seeks equity must do equity; **WHEREAS**, the Master should have found that the filing of said cross-petition by the trustee and the granting thereof by the Court, and the sale in pursuance of said petition, and confirmation of said sale, was not a sufficient 'coming in' to a court of equity to make applicable the principle that he who seeks equity must do equity."

XX.

The Court erred in entering its said decree that claims of said claimants named in said decree must be paid in full, irrespective of the question of diversion of current funds, and are entitled to priority against the bondholders and purchasers of said Ocean Shore Railway Company and their successors and assigns, to the full amount of the claims, and that said claims should be made [114] a first and prior lien upon all said properties, because said decree takes from intervenors their property for a public use without just, or any, compensation, contrary to the provisions of the Constitution of the United States.

XXI.

The Court erred in entering its said decree that claims of said claimants named in said decree must be paid in full, irrespective of the question of diver-

sion of current funds, and are entitled to priority against the bondholders and purchasers of said Ocean Shore Railway Company, and their successors and assigns, to the full amount of the claims, and that said claims should be made a first and prior lien upon all said properties, because in and by said decree intervenors will be deprived of their property without due process of law, contrary to the provisions of the Constitution of the United States.

XXII.

The Court erred in entering its said decree that claims of said claimants named in said decree must be paid in full, irrespective of the question of diversion of current funds, and are entitled to priority against the bondholders and purchasers of said Ocean Shore Railway Company and their successors and assigns, to the full amount of the claims, and that said claims should be made a first and prior lien upon all said properties because in and by said decree the obligation of the trust deed executed by Ocean Shore Railway Company and Mercantile Trust Company of San Francisco on November 1, 1905, is impaired, contrary to the provisions of the Constitution of the United States. [115]

WHEREFORE, the said Intervenor, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, pray that the said decree may be reversed and that the said Circuit Court of Appeals may enter a decree in favor of the said intervenors ordering and decreeing that the rights of all claimants named in said decree entered by said District Court of the United States on the

18th day of July, 1913, are, and that each of them is, subsequent and subordinate to the rights of these intervenors, and that these intervenors have a lien upon the properties of Ocean Shore Railway Company purchased by them at said sale on January 17, 1911, prior and superior to the lien of any of said claimants named in said decree.

EDW'D J. McCUTCHEN,
A. CRAWFORD GREENE,
McCUTCHEN, OLNEY & WILLARD and
GAVIN McNAB,

Solicitors for Said Intervenors, Charles C. Moore,
F. W. Bradley, Maurice Schweitzer, R. D. Robbins,
and Walter S. Martin.

[Endorsed]: Filed Aug. 15, 1913. W. B. Maling,
Clerk. By J. A. Schaertzer, Deputy Clerk. [116]

*In the District Court of the United States, for the
Northern District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,

Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,

Respondent.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROBBINS,
WALTER S. MARTIN et al.,

Intervenors.

**Order Permitting an Appeal and Fixing Amount of
Supersedeas and Appeal Bond.**

WHEREAS, in the District Court of the United States, Ninth Circuit, Northern District of California, on the 18th day of July, 1913, a decree was made and entered in the above-entitled cause confirming the reports of H. M. Wright, Standing Master in Chancery of the above-entitled court, on debts accruing prior to the appointment of the receiver in said cause, and on debts accruing during said receivership, except as to the finding and conclusion therein contained that certain claims accruing between June 1, 1909, and December 6, 1909, the date of the appointment of the receiver herein, found to be preferential in character, are entitled to payment only to the extent to which current earnings of that period were diverted to the payment of the current obligations of that period, viz., thirty thousand dollars, the said court, as to such preferential claims, sustaining the [117] exceptions of said claimants, and ordering that said claims must be paid in full to the extent and in the amount that they are found to be preferential, irrespective of the question of the diversion of current funds, and that they are entitled to priority as against the bondholders and purchasers of said Ocean Shore Railway Company and their successor or successors or assigns to the full amount of their claims; and making said claims, and each of them, a lien upon all properties of said Ocean Shore Railway Company sold by the Trustee under said deed of trust, and directing that the said

properties be sold for the purpose of satisfying and discharging said lien; and,

WHEREAS, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, intervenors in the above-entitled action, have, on this 15th day of August, 1913, filed their petition for the allowance of an appeal from said decree (severed from all interest of A. C. Kains, a party to said action), to the United States Circuit Court of Appeals, Ninth Circuit, together with an assignment of errors, in and by which said petition they have prayed that an order be made fixing the amount of the supersedeas bond which they shall give and furnish on said appeal:

NOW, THEREFORE, in consideration of the premises, and good cause appearing therefor, it is ordered that said appeal be, and the same is hereby, permitted and allowed, and that said appeal may be prosecuted by said intervenors as to their own interest and severed from all interest of the said A. C. Kains.

IT IS FURTHER ORDERED that the said Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter [118] S. Martin, intervenors herein, shall file their undertaking and supersedeas bond in form and substance conditioned, and with sureties, in accordance with the provisions of the law and the rules and practice of this court, in the said United States District Court in the sum of fifteen thousand (15,000) dollars, which said bond and sureties thereon shall be approved before filing,

and said amount is hereby fixed as the amount of said bond.

Said bond to be approved by a Judge of this court.

WM. C. VAN FLEET,
United States District Judge.

[Endorsed]: Filed Aug. 15, 1913. W. B. Maling,
Clerk. By J. A. Schaertzer, Deputy Clerk. [119]

*In the District Court of the United States, for the
Northern District of California, Second Divi-
sion.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,
Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,
Respondent.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROB-
BINS, WALTER S. MARTIN et al.,
Intervenors.

Bond on Appeal.

KNOW ALL MEN BY THESE PRESENTS:
That the undersigned, the American Surety Com-
pany of New York, a corporation duly organized and
existing under and by virtue of the laws of the State
of New York, and duly authorized to transact busi-
ness in the State of California, and fully qualified
before the Department of Justice to execute bonds
and undertakings in any and all Federal courts of

the United States of America, is held and firmly bound unto all those preferred claimants, and the solicitors for said claimants, named in a certain order and decree of the above-entitled court, made and entered on the eighteenth day of July, 1913, in the full and just sum of fifteen thousand (15,000) dollars, to be paid to the said preferred claimants, and their solicitors, their successors and assigns, to which payment, well and truly to be made, we bind ourselves and our successors by these presents.

SEALED with our seals, and dated this 16th day of August, A. D. 1913. [120]

WHEREAS, lately at a session of the District Court of the United States, for the Northern District of California, in a suit pending in said court between Baldwin Locomotive Works, complainant, and Ocean Shore Railway Company, defendant, and others, a decree was rendered against Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, intervenors in the above-entitled action, and the said intervenors having obtained from said court its order allowing them to appeal to the United States Circuit Court of Appeals, Ninth Circuit, in the aforesaid suit, and a citation directed to all the preferred claimants named in said decree, as well as to their solicitors named in said decree, and to each of them, citing and admonishing them to appear at the United States Circuit Court of Appeals, for the Ninth Circuit, to be holden at San Francisco, in the State of California, on or before the 15th day of September, 1913;

NOW, THE CONDITION of the above obligation is such that, if the said Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, intervenors herein, shall prosecute their said appeal to effect, and answer all damages and costs that may be awarded against them if they shall fail to make their plea good, then the above obligation to be void; else to remain in full force and effect.

IN WITNESS WHEREOF, the said AMERICAN SURETY COMPANY OF NEW YORK has hereunto caused its corporate name to be signed and attested, and its corporate seal to be affixed by its duly authorized officers, at San Francisco, California, this 16th day of August, 1913. [121]

AMERICAN SURETY COMPANY OF
NEW YORK.

[Seal]

By H. J. DOUGLAS,
Resident Vice-President.

Attest: R. D. WELDON,
Resident Assistant Secretary.

This bond is approved this 16th day of August, 1913.

WM. C. VAN FLEET,
Judge.

[Endorsed]: Filed Aug. 16, 1913. W. B. Maling,
Clerk. By J. A. Schaertzer, Deputy Clerk. [122]

*In the District Court of the United States, for the
Northern District of California, Second Division.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,

Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,

Respondent.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROBBINS,
and WALTER S. MARTIN,

Intervenors.

Order to Transmit Original Exhibit.

WHEREAS, the report of H. M. Wright, Standing Master in Chancery of the above-entitled court, on file in the above-entitled action, is of great length and contains many intricate schedules, the printing of which would be very expensive; and,

WHEREAS, an appeal from the decree made and entered herein on the 18th day of July, 1913, has been permitted to Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, intervenors herein:

NOW, THEREFORE, on motion of the solicitors for said intervenors, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, and good cause appearing therefor, it is ordered that the said report filed herein shall be by the clerk of this court transmitted to the United

States Circuit Court of Appeals for the Ninth Circuit, for the use and inspection of said Court [123] on said appeal, and that the same need not be copied in the transcript of record upon appeal of this case.

Dated: San Francisco, California, Dec. 15th, 1913.

WM. C. VAN FLEET,
Judge.

[Endorsed]: Filed Dec. 16, 1913. W. B. Maling, Clerk. By J. A. Schaertzer, Deputy Clerk. [124]

In the District Court of the United States, for the Northern District of California, Second Division.

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,
Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,
Respondent.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROB-
BINS, and WALTER S. MARTIN et al.,
Intervenors.

Praecipe [for Transcript of Record].

The clerk of the above-entitled court will please, prepare a transcript of the record for the Appellate Court in the above-entitled cause, and is directed to insert therein the following:

(1) The agreed statement heretofore filed in the above-entitled cause on December —, A. D. 1913.

(2) The final decree made and entered on July 18, 1913.

(3) All papers filed by intervenors, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin in the prosecution of their appeal, including summons and severance, refusal to join, petition for appeal, assignment of errors, order permitting appeal, and citation on appeal, the appeal bond and the approval of the same.

E. J. McCUTCHEN, GAVIN McNAB,
A. C. GREENE,

Solicitors for Intervenors Charles C. Moore et al.

McCUTCHEN, OLNEY & WILLARD,
Of Counsel.

[Endorsed]: Filed Dec. 16, 1913. W. B. Maling,
Clerk. By J. A. Schaertzer, Deputy Clerk. [125]

**[Certificate of Clerk U. S. District Court to
Transcript of Record.]**

*In the District Court of the United States, for the
Northern District of California, Second Divi-
sion.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,
Complainant,

vs.

OCEAN SHORE RAILWAY COMPANY,
Defendant.

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROB-
BINS, WALTER S. MARTIN,
Intervenors.

CLERK'S CERTIFICATE TO RECORD ON
APPEAL.

I, Walter B. Maling, Clerk of the District Court of the United States in and for the Northern District of California, do hereby certify the foregoing one hundred and twenty-five (125) pages, numbered from 1 to 125, inclusive, to be a full, true and correct copy of the Agreed Statement on Appeal, together with exhibits attached thereto; Decree confirming Master's Report; Summons and Severance; Refusing to Join in Appeal; Petition for Appeal; Assignment of Errors; Order Permitting Appeal and Fixing Amount of Bond; Bond on Appeal; Order to Transmit Original Exhibits and Praeceptum for Record, filed in the above-entitled cause, and that the same constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the cost of the foregoing transcript of record on appeal is \$89.30, that said amount was paid by Messrs. McCutchen, Olney & Willard, attorneys for C. C. Moore et al., Interveners, and that the original citation issued in said cause is hereto annexed.

In testimony whereof, I have hereunto set my hand and affixed the seal of said District Court, this 22d day of December, A. D. 1913.

[Seal] WALTER B. MALING,
Clerk of United States District Court, Northern District of California. [126]

[Citation on Appeal.]

UNITED STATES OF AMERICA,—ss.

The President of the United States, to F. L. Donahoo, L. T. Coates, H. L. Staples, Mrs. J. E. Shilladey, C. E. Bass, J. L. Whissen, H. L. Goodloe, R. J. Ellis, Oliver W. Hall, E. G. Gray, S. K. Woodburn, Fred L. Sparks, O. J. Effenbeck, J. A. Roix, W. N. Silsby, W. D. Wilcox, F. A. Stoekel, Wm. A. Roix, J. Matthews, J. W. Gray, F. H. Sage, Oscar S. Westberg, R. P. Standley, W. B. Scott, H. Horn, C. Becker, George W. Agnew, D. W. Bale, J. W. Carter, C. Conto, L. Lucas (or Lukas), F. J. Lyons, John J. Dake, Henry Rosenblad (or Rosenblatt), Daniel Keith, M. H. Lawson, John Kennedy, Xavier Pasqualine, C. E. Twisselman, E. B. Shilladey, Fred Helin, D. R. Parsley, S. George, M. Moeller, S. F. Dart, A. Poulos, John Conto, J. Vorigachis, Charles T. Faucett, Patrick Cavanaugh, James Rosar, A. E. Siebel (or Siegel), A. J. Ault, F. J. Bettinger, N. Louto, George Doody, R. H. Shaves, J. Markis, J. Metzger, F. J. Reedy, C. E. Wilcox, E. L. Brasswell, Chris Economou (or Conomu), Gus Kostakis, F. Legourious (Legoris), N. Spiros, Mike Popovitz, P. Judas, C. Pappas, J. Gergusiakis, P. Drulis, C. Pappas, N. Papostolu, P. Nickolas, P. Paulis, J. Paulis, J. Kafolas, P. Miles, P. Kafo-las, J. Pandaces, M. Panos, M. Simon, J. G. James Co., Wm. C. Knox, Chas. H. Wilson, C. B. Johnson, Louis Lait, T. E. Vanomen, Aug.

Johnson, Dr. A. S. Keenan, P. O'Farrell, J. F. Giblin, Fairbanks, Morse & Co., J. Homer Fritch, Inc., W. L. Holman Co., Remington Typewriter Co., Acme Lumber Co., E. W. Thomas Oil Burner Co., Western Building Material Co., San Francisco Gas & Electric Co., Southern Pacific Company, Dr. J. C. Spencer, E. Moulty, John Hurley, Mary Knights, Colita Chatard, Clara Ferini, W. P. Geary, John Noriega, E. L. Smith, J. H. Hurlbut, W. J. Berger, Dr. Albert B. McKee, Drs. Phillips & Phillips, Dr. W. A. Brooks (or Brooke), Clara Greene, L. C. Greene, Francis M. Sellers, D. H. (or E. H.) Danmann, A. L. Geggus, J. W. Crosby, J. M. Gilbert, P. P. Chatard, H. V. Rippon, Carl Sager, Metta E. Stross, C. N. Compton, Louis Zachert, Gus D. Hurlbut, Frank L. Sawyer, W. M. Boeken, Mary J. Hanley, E. T. Charlton, Chas. E. Croly, W. N. Frye, Sidney Sprout, Smith Emery Co., F. A. Hihn Co., Australian Hardwood Co., California Litho. Co., A. Carlisle & Co., S. F. Call, Dow Pump Eng. Co. [127] Eccles & Smith Co., John Finn Metal Wks., General Electric Co., Gallagher & Motts, Great Western Smelting & Refining Co., Holmes Lime Co., G. M. Josselyn & Co., L. Kingswell, Peck-Judah Co., J. A. Roebbling's Sons Co., Squire & Byrne, Enterprise Foundry Co., White Brothers, Pinkerton's National Detective Agency, Dr. W. C. Hopper, Helen W. Lee, E. S. Reinoehl, Thos. Day Co., Ft. Pitt Spring Mfg. Co., Gould Coupler Co., Joost Bros., Smith Copper Works,

Fred Ward & Son, Ernest De Temple, L. & M. Alexander & Co., Santa Cruz Water Wks., F. G. Barclay, Charles Butler, M. J. Howe, P. Long, D. J. McGowan, M. J. McGuire, James Mills, Timothy O'Driscoll, Thos. J. O'Keefe, C. O. Reeves, M. R. Twomey, Thomas H. Williams, Michael Albrecht, John Fitzpatrick, Patrick Galvin, Thomas E. Hanley, J. W. Manning, Wm. A. Stoll, Peter White, Charles Colson, Louis Irons, Chas. W. Baker, Wm. Otterson, K. O. Whitson, H. P. Thomas, E. P. Lenox, John Kenny, Wm. A. Doyle, F. L. Berry, E. L. (or G. L.) Duncan, I. W. Fleming, J. S. Grow, Thomas Hewitt, L. Welch, A. Engelson, Wm. H. Baxter, T. M. Daly, H. P. Elliott, C. W. Finch, M. E. Hale, J. J. Higgins, M. S. Kentzell, Owen Larkin, G. (or J.) Priola, A. Shilling, S. L. Kampschmidt, F. F. Roake, George G. Smith, F. L. Browne, Jas. Casper, H. H. McEwen, Charles Jarvis, H. H. Jordan, J. L. Cunningham, J. O. Frain, F. W. Cassidy, S. J. Murphy, Peter Johnson, J. H. Murphy, B. T. (or B. F.) Cowgill, Coffin Redington & Co., W. P. Fuller & Co., Gorham Rubber Co., Pacific Hardware & Steel Co., Schwabacher, Frey Sta. Co., Selby Smelting & Lead Co., Geo. H. Tay Co., A. L. Young Mach. Co., Zellerbach Paper Co., Postal Telegraph Cable Co., Westinghouse Airbrake Co., Westinghouse Traction Brake Co., Simplex Ry. Appliance Co., S. K. Mitsuse, C. P. Mosconi, S. Skliris, N. Paris, Patrick Moloney, Trustee of the Estate of C. O'Connor, deceased, Michael

Clark, Gertrude H. Collins, Boyce Lumber Co., E. J. Boyce, Mary E. Bates, D. E. Besecker, Pacific States Elec. Co., Knox Collection Agency, F. O. Rood (Assignee), J. Miller (Assignee), A. S. Lozier, A. Kiniafatos, Spring Valley Water Co., Gibson & Woolner, R. P. Ashe, I. S. Chapman, Williamson & Dibblee, Walter Christie, — O'Donnell, L. T. Jacks, W. B. Bosley and Leo H. Sussman, C. A. Strong, F. M. Hultman, J. P. Langhorne & Richard Bayne, R. S. Norman, L. T. Hengstler, Chas. J. Heggerty, Cushing & Cushing, J. R. Pringle, W. H. Barrows, J. C. Campbell, Wm. A. Nunlist, Othello C. Pratt, Weinmann, Wood & Cunha, W. C. Graves, S. C. Wright, C. E. Lindsay, Neal Power, Kennedy & Kirk, Marshall Nuckolls, John O. McElroy, M. R. Carey, Sullivan & Sullivan, and Theo. J. Roche, Goodfellow, Eells & Orrick, H. M. Wright (Master), F. S. Stratton, as Receiver of Ocean Shore Railway Company, and Mercantile Trust Company of San Francisco, Greeting:
[128]

YOU ARE HEREBY CITED and admonished to be and appear at a United States Circuit Court of Appeals, for the Ninth Circuit, to be holden at the City and County of San Francisco, State of California, on the 15th day of September, 1913, being within thirty days from the date hereof, pursuant to an order allowing an appeal filed in the clerk's office to the District Court of the United States, for the Northern District of California, Second Division, wherein Charles C. Moore, F. W. Bradley, Maurice

Schweitzer, R. D. Robbins and Walter S. Martin, intervenors in said action, are appellants, and you are appellees, to show cause, if any there be, why the decree rendered against the said appellants, as in the said order allowing appeal mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

WITNESS, the Honorable WILLIAM C. VAN FLEET, United States District Judge for the Northern District of California, this 16th day of August, A. D. 1913.

WM. C. VAN FLEET,
United States District Judge. [129]

Due service and receipt of a copy of the foregoing Citation is hereby admitted this 18th day of August, 1913.

MAURICE R. CAREY,
Solicitor for F. L. Donahoo et al.,

Solicitor for C. E. Wilcox,
BELLEW & WRIGHT,
Solicitor for E. L. Brassell,

J. O. McELROY,
Solicitor for Chris Economou et al.,

W. C. GRAVES,
Solicitor for J. G. James Co.,

WM. C. KNOX,
In pro. per.,

S. S. WRIGHT and
W. H. SCHULTE,
Solicitors for Chas. H. Wilson,

MARSHALL NUCKOLLS,
Solicitor for C. B. Johnson,

O. C. PRATT,
Solicitor for Louis Lait,
FRANK M. HULTMAN,
Solicitor for August Johnson,
W. W. ALLEN,
Solicitor for Dr. A. S. Keenan,
F. J. KIERCE,
Solicitor for P. O'Farrell. [130]

Due service and receipt of a copy of the foregoing
Citation is hereby admitted this 18th day of August,
1913.

Solicitor for J. F. Giblin,
L. T. JACKS,
Solicitor for J. Homer Fritch, Inc.,
CUSHING & CUSHING,
Solicitors for Remington Typewriter Co.
Rec'd copy of foregoing Sep. 10, '13.
WEBSTER, WEBSTER & BLEWETT and
ALEXANDER & O'DONNELL,
Solicitors for E. W. Thomas Oil Burner Co.
WM. B. BOSLEY and
LEO. H. SUSMAN,
Solicitors for San Francisco Gas and Electric Co.,
GOODFELLOW, EELLS & ORRICK,
Solicitors for Dr. J. C. Spencer et al.,
WEINMANN, WOOD & CUNHA,
Solicitors for B. T. Cowgill,
RICHD. BAYNE,
Solicitor for Postal Tel. Cable Company et al.,
CHARLES A LEE,
Solicitor for S. Skliris,

- CARL E. LINDSAY,
Solicitor for S. K. Mitsuse,
R. S. NORMAN,
Solicitor for Patrick Moloney,
BARROWS & BARROWS,
Solicitors for Gertude H. Collins,
METSON, DREW & MACKENZIE,
Solicitors for Fairbanks, Morse & Co.,
WILLIAMSON & DIBBLEE,
Solicitor for W. L. Holman Co.
CHARLES A. STRONG,
Solicitor for Acme Lumber Co.,
J. R. PRINGLE,
Solicitor for Western Building Material Company.
E. J. FOULDS,
Solicitor for Southern Pacific Company.
- Received copy of citation Aug. 19/13.
- SULLIVAN & SULLIVAN and
THEO. J. ROCHE,
Solicitors for F. G. Barclay et al.,
JOSEPH KIRK and
J. L. KENNEDY,
Solicitors for Coffin, Redington & Company et al.,
ANDROS & HENGSTLER,
Solicitors for Simplex Ry. Appliance Co.,
R. PORTER ASHE,
Solicitor for C. P. Mosconi,
WILLIAM A. NUNLIST,
Solicitor for N. Paris,
Not (W. A. T.)

KNIGHT & HEGGERTY,

Solicitor for Trustee of Estate of C. O'Connor,
Deceased,

GIBSON & WOOLNER,

Solicitors for Boyce Lumber Company et al.,

CULLINAN & HICKEY,

Solicitors for Michael Clark. [131]

Due service and receipt of a copy of the foregoing
Citation is hereby admitted this 21st day of August,
1913.

JOS. KIRK and

J. L. KENNEDY,

Solicitors for W. P. Fuller & Co.; Geo. H. Tay Co.
et al.,

H. M. WRIGHT,

Master (Rec'd Sept. 5, 1913).

Received copy of foregoing citation this 4th day of
Sept. 1913.

MORRISON, DUNNE & BROBECK,

Solicitors for Mercantile Trust Company.

Received copy of the foregoing citation this 3rd
day of Sept. 1913.

W. W. KAUFMAN,

Solicitor for F. S. Stratton, Receiver of Ocean Shore
Railway Company.

KNOX COLLECTION AGENCY,

By WM. C. KNOX, Mgr.

Received a copy Sep. 12, 1913.

D. E. BESECKER.

Received a copy of the within this 13th day of
Sept. 1913.

SPRING VALLEY WATER CO.,

By JOHN E. BEHAN, Secretary. [132]

*In the District Court of the United States, for the
Northern District of California, Second Di-
vision.*

No. 15,008.

BALDWIN LOCOMOTIVE WORKS,
Complainant,
vs.
OCEAN SHORE RAILWAY COMPANY,
Respondent,
CHARLES C. MOORE et al.,
Intervenors.

Admission of Service.

Due service and receipt of a copy of the foregoing citation is hereby admitted this 22nd day of August, 1913.

EMMET C. RITTENHOUSE,
Solicitor for J. F. Giblin. [134]

[Endorsed]: No. 15,008. In the District Court of the United States, Second Division, Northern District of California, Baldwin Locomotive Works, Complainant, vs. Ocean Shore Railway Company, Respondent. Charles C. Moore et al., Intervenors. Citation, with Proof of Service. Filed Dec. 16, 1913. W. B. Maling, Clerk. By J. A. Schaertzer, Deputy Clerk.

[Endorsed]: No. 2353. United States Circuit Court of Appeals for the Ninth Circuit. Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin Intervenors, Appel-

lants, vs. F. L. Donahoo, L. T. Coates, H. L. Staples, Mrs. J. E. Shilladey, C. E. Bass, J. L. Whissen, H. L. Goodloe, R. J. Ellis, Oliver W. Hall, E. G. Gray, S. K. Woodburn, Fred L. Sparks, O. J. Effenbeck, J. A. Roix, W. N. Silsby, W. D. Wilcox, F. A. Stoekel, Wm. A. Roix, J. Matthews, J. W. Gray, F. H. Sage, Oscar S. Westberg, R. P. Standley, W. B. Scott, H. Horn, C. Becker, George W. Agnew, D. W. Bale, J. W. Carter, C. Conto, L. Lucas (or Lukas), F. J. Lyons, John J. Dake, Henry Rosenblad (or Rosenblatt), Daniel Keith, M. H. Lawson, John Kennedy, Xavier Pasqualine, C. E. Twisselman, E. B. Shilladey, Fred Helin, D. R. Parsley, S. George, M. Moeller, S. F. Dart, A. Poulos, John Conto, J. Vorigachis, Charles T. Faucett, Patrick Cavanaugh, James Rosar, A. E. Siebel (or Siegel), A. J. Ault, F. J. Bettinger, N. Louto, George Doody, R. H. Shaves, J. Markis, J. Metzger, F. J. Reedy, C. E. Wilcox, E. L. Brasswell, Chris Economou (or Conomu), Gus Kostakis, F. Legourious (Legoris), N. Spiros, Mike Popovitz, P. Judas, C. Pappas, J. Gergusiakis, P. Drulis, C. Pappas, N. Papostolu, P. Nickolas, P. Paulis, J. Paulis, J. Kafolas, P. Miles, P. Kafolas, J. Pandaces, M. Panos, M. Simon, J. G. James Co., Wm. C. Knox, Chas. H. Wilson, C. B. Johnson, Louis Lait, T. E. Vanomen, Aug. Johnson, Dr. A. S. Keenan, P. O'Farrell, J. F. Giblin, Fairbanks, Morse & Co., J. Homer Fritch, Inc., W. L. Holman Co., Remington Typewriter Co., Acme Lumber Co., E. W. Thomas Oil Burner Co., Western Building Material Co., San Francisco Gas & Electric Co., Southern Pacific Company, Dr. J. C. Spencer, E. Moulty,

John Hurley, Mary Knights, Colita Chatard, Clara Ferini, W. P. Geary, John Noriega, E. L. Smith, J. H. Hurlbut, W. J. Berger, Dr. Albert B. McKee, Drs. Phillips & Phillips, Dr. W. A. Brooks (or Brooke), Clara Greene, L. C. Greene, Francis M. Sellers, D. H. (or E. H.) Danmann, A. L. Geggus, J. W. Crosby, J. M. Gilbert, P. P. Chatard, H. V. Rippon, Carl Sager, Metta E. Stross, C. N. Compton, Louis Zachert, Gus D. Hurlbut, Frank L. Sawyer, W. M. Boeken, Mary J. Hanley, E. T. Charlton, Chas. E. Croly, W. N. Frye, Sidney Sprout, Smith Emery Co., F. A. Hihn Co., Australian Hardwood Co., California Litho. Co., A. Carlisle & Co., S. F. Call, Dow Pump Eng. Co., Eccles & Smith Co., John Finn Metal Wks., General Electric Co., Gallagher & Motts, Great Western Smelting & Refining Co., Holmes Lime Co., G. M. Josselyn & Co., L. Kingswell, Peck-Judah Co., J. A. Roebling's Sons Co., Squire & Byrne, Enterprise Foundry Co., White Brothers, Pinkerton's National Detective Agency, Dr. W. C. Hopper, Helen W. Lee, E. S. Reinoehl, Thos. Day Co., Ft. Pitt Spring Mfg. Co., Gould Coupler Co., Joost Bros., Smith Copper Works, Fred Ward & Son, Ernest De Temple, L. & M. Alexander & Co., Santa Cruz Water Wks., F. G. Barclay, Charles Butler, M. J. Howe, P. Long, D. J. McGowan, M. J. McGuire, James Mills, Timothy O'Driscoll, Thos. J. O'Keefe, C. O. Reeves, M. R. Twomey, Thomas H. Williams, Michael Albrecht, John Fitzpatrick, Patrick Galvin, Thomas E. Hanley, J. W. Manning, Wm. A. Stoll, Peter White, Charles Colson, Louis Irons, Chas. W. Baker, Wm.

Otterson, K. O. Whitson, H. P. Thomas, E. P. Lenox, John Kenny, Wm. A. Doyle, F. L. Berry, E. L. (or G. L.) Duncan, I. W. Fleming, J. S. Grow, Thomas Hewitt, L. Welch, A. Engelson, Wm. H. Baxter, T. M. Daly, H. P. Elliott, C. W. Finch, M. E. Hale, J. J. Higgins, M. S. Kentzell, Owen Larkin. G (or J.) Priola, A. Shilling, S. L. Kampschmidt, F. F. Roake, George G. Smith, F. L. Browne, Jas. Casper, H. H. McEwen, Charles Jarvis, H. H. Jordan, J. L. Cunningham, J. O. Frain, F. W. Cassidy, S. J. Murphy, Peter Johnson, J. H. Murphy, B. T. (or B. F.) Cowgill, Coffin, Redington & Co., W. P. Fuller & Co., Gorham Rubber Co., Pacific Hardware & Steel Co., Schwabacher-Frey Sta. Co., Selby Smelting & Lead Co., Geo. H. Tay Co., A. L. Young Mach. Co., Zellerbach Paper Co., Postal Telegraph Cable Co., Westinghouse Air-Brake Co., Westinghouse Traction Brake Co., Simplex Ry. Appliance Co., S. K. Mitsuse, C. P. Mosconi, S. Skliris, N. Paris, Patrick Moloney, Trustee of the Estate of C. O'Connor, Deceased, Michael Clark, Gertrude H. Collins, Boyce Lumber Co., E. J. Boyce, Mary E. Bates, D. E. Besecker, Pacific States Elec. Co., Knox Collection Agency, F. O. Reed (Assignee), J. Miller (Assignee), A. S. Lozier, A. Kiniafatos, Spring Valley Water Co., Gibson & Woolner, R. P. Ashe, I. S. Chapman, Williamson & Dibblee, Walter Christie, — O'Donnell, L. T. Jacks, W. B. Bosley, and Leo H. Sussman, C. A. Strong, F. M. Hultman, J. P. Langhorne & Richard Bayne, R. S. Norman, L. T. Hengstler, Chas. J. Heggerty, Cushing & Cushing, J. R. Pringle, W. H. Barrows, J. C. Campbell, Wm.

A. Nunlist, Othello C. Pratt, Weinmann, Wood & Cunha, W. C. Graves, S. C. Wright, C. E. Lindsay, Neal Power, Kennedy & Kirk, Marshall Nuckolls, John O. McElroy, M. R. Carey. Sullivan & Sullivan, and Theo. J. Roche, Goodfellow, Eells & Orrick, H. M. Wright (Master), F. S. Stratton, as Receiver of Ocean Shore Railway Company; and Mercantile Trust Company of San Francisco, Appellees. Transcript of Record. Upon Appeal from the United States District Court for the Northern District of California, Second Division.

Received and Filed December 22, 1913.

F. D. MONCKTON,

Clerk.

By Meredith Sawyer,

Deputy Clerk.

In the United States District Court, Northern District of California, Second Division.

IN EQUITY—No. 15,008.

BALDWIN LOCOMOTIVE WORKS, a Corporation,

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY, a Corporation, C. C. MOORE et al.,

Intervenors.

Order Enlarging Time [to October 15, 1913] to File Record.

Now at this day, for good cause shown, it is ordered that the time of the intervenors herein, Charles

C. Moore, F. W. Bradley, Maurice Schweitzer. R. D. Robbins and Walter S. Martin, for printing the record and filing and docketing this cause on appeal in the United States Circuit Court of Appeals for the Ninth Circuit be, and the same is hereby, enlarged and extended thirty (30) days from and after the 15th day of September, 1913.

Dated: September 10th, 1913.

WM. C. VAN FLEET,
District Judge.

[Endorsed]: No. 15,008. United States District Court, Northern District of California, Second Division. In Equity. Baldwin Locomotive Works, a Corporation, Plaintiff, vs. Ocean Shore Railway Company, a Corporation, C. C. Moore et al., Interveners. Order Enlarging Time to File Record. Filed Sept. 11, 1913. F. D. Monckton, Clerk.

In the United States District Court, Northern District of California, Second Division.

IN EQUITY—No. 15,008.

BALDWIN LOCOMOTIVE WORKS, a Corporation,
Plaintiff,

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY, a Corporation, C. C. MOORE et al.,

Interveners.

Order Enlarging Time [to November 14, 1913] to File Record.

Now at this day, for good cause shown, it is ordered that the time of the Interveners herein,

Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, for printing the record and filing and docketing this cause on appeal in the United States Circuit Court of Appeals for the Ninth Circuit be, and the same is hereby, enlarged and extended thirty (30) days from and after the fifteenth day of October, 1913.

Dated: October 14th, 1913.

WM. C. VAN FLEET,

District Judge.

[Endorsed]: No. ——. In the District Court of the United States, Second Division, Northern District of California. In Equity. Baldwin Locomotive Works, a Corporation, Plaintiff, vs. Ocean Shore Railway Company a Corporation, C. C. Moore et al., Intervenors. Order Enlarging Time to File Record. Filed Oct. 14, 1913. F. D. Monckton, Clerk.

In the United States Circuit Court of Appeals, Ninth Circuit.

IN EQUITY—No. 15,008.

BALDWIN LOCOMOTIVE WORKS, a Corporation,
 tion,

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY, a Corporation, C. C. MOORE et al.,

Intervenors.

**Order Enlarging Time [to December 13, 1913] to
File Record.**

Now at this day, for good cause shown, it is ordered that the time of the intervenors herein, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, for printing the record and filing and docketing this cause on appeal in the United States Circuit Court of Appeals for the Ninth Circuit be, and the same is hereby, enlarged and extended thirty (30) days from and after the 14th day of November, 1913.

Dated: Nov. 13th, 1913.

WM. C. VAN FLEET,
District Judge.

[Endorsed]: No. 15,008. In the U. S. Circuit Court of Appeals. Baldwin Locomotive Works, Plaintiff, vs. Ocean Shore Railway Company, et al., Intervenors. Order Enlarging Time to File Record. Filed Nov. 13, 1913. F. D. Monckton, Clerk.

In the United States District Court, Northern District of California, Second Division.

IN EQUITY—No. 15,008.

BALDWIN LOCOMOTIVE WORKS, a Corporation,
Plaintiff,

Plaintiff,

vs.

OCEAN SHORE RAILWAY COMPANY, a Corporation,
C. C. MOORE et al.,

Intervenors.

Order Enlarging Time [to January 2, 1914] to File Record.

Now at this day, for good cause shown, IT IS ORDERED that the time of the intervenors herein, Charles C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, for printing the record and filing and docketing this cause on appeal in the United States Circuit Court of Appeals for the Ninth Circuit be, and the same is, hereby enlarged and extended twenty (20) days from and after the 13th day of December, 1913.

Dated: December 13th, 1913.

WM. C. VAN FLEET,
District Judge.

[Endorsed]: No. 15,008. In the District Court of the United States, Northern District of California, Second Division. In Equity. Baldwin Locomotive Works, a Corporation, Plaintiff, vs. Ocean Shore Railway Company, a Corporation, C. C. Moore et al., Intervenors. Order Enlarging Time to File Record. Filed Dec. 13, 1913. F. D. Monckton, Clerk.

No. 2353. United States Circuit Court of Appeals for the Ninth Circuit. Four Orders Under Rule 16 Enlarging Time to Jan. 3, 1914, to File Record Thereof and to Docket Case. Refiled Dec. 22, 1913. F. D. Monckton, Clerk.

No. 2353

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CHARLES C. MOORE, F. W. BRADLEY, MAURICE
SCHWEITZER, R. D. ROBBINS and WALTER
S. MARTIN,

Intervenors and Appellants,

vs.

F. L. DONAHOO, et al.,

Appellees.

BRIEF FOR APPELLANTS.

“The question involved in this case is that of discovering upon what principles and under what limitations an unsecured creditor of an insolvent railroad in the hands of a court of equity may displace a previously vested mortgage lien, given to secure bonds and covering all property and all income in specific terms.” (Master’s Report, p. 14.)

Statement of the Case.

On December 6, 1909, Ocean Shore Railway Company, a California corporation, owned and was operating a

line of railroad from San Francisco to Tunitas Glen, in San Mateo County, a distance of approximately 38 miles, and also a line of railroad extending from the City of Santa Cruz northerly for about 16 miles. More than four years prior to this date, and on November 1, 1905, Ocean Shore Railway Company, to secure an issue of bonds of the face value of \$5,000,000, had conveyed to Mercantile Trust Company of San Francisco, by deed of trust in form similar to the usual railroad mortgage, all property then owned by it, as well as all property of every kind which it might subsequently acquire (Record, pp. 2-6). All of the bonds thus secured, except those of a value of \$4500, were issued and outstanding in December, 1909. By the terms of the deed of trust and the coupons attached to the bonds, it was provided that Ocean Shore Railway Company should pay interest on each of said bonds on the first days of May and November of each year, at the rate of five per cent. per annum, and it was also provided that, in case of failure of the Ocean Shore Railway Company so to do, the Trustee, Mercantile Trust Company of San Francisco, might sell the properties, so conveyed, at public auction, subject to the provisions of the deed of trust. The railway company did not pay the interest due on the bonds on either the first day of May or the first day of November, 1909.

On December 6, 1909, in what was then the Circuit Court of the United States for Northern District of California, a bill of complaint was filed by Baldwin Locomotive Works, a Pennsylvania corporation, as complainant, against the railway company as defendant, there

being no other parties to the bill. There was therein alleged the indebtedness of the railway company to complainant on certain past-due promissory notes, an unsecured indebtedness to other creditors in a sum amounting to more than \$1,900,000, and the fact that the suit was commenced in behalf of complainant and all other outstanding creditors of the railway company who might desire to join in the suit and become parties thereto. The fact that the railway company was insolvent, the danger that various unsecured creditors of the company might levy execution upon the properties of the company to the great disadvantage of the company and its creditors, and that a multiplicity of suits might ensue if such action should be taken, the existence of the bonded indebtedness above referred to,—all these facts were set forth in the bill, and the court was asked to appoint a receiver to take possession of and operate the properties. On the same day on which the complaint was filed the railway company filed its answer admitting all the allegations of the bill and joining in its prayer. F. S. Stratton was thereupon appointed receiver of the railway company and its properties and at once entered upon the performance of his duties.

Pursuant to the provisions of the deed of trust, Mercantile Trust Company of San Francisco did, on the 12th day of May, 1910, by formal written notice, declare both the principal and interest of the bonds, secured thereby, to be forthwith due and payable. It did, further, on the 7th day of June, 1910, duly cause a notice of trustee's sale of the properties of the railway company to be published as required by the deed of trust,

the notice fixing the time of sale as September 1, 1910. The sale was, on September 1, duly adjourned and postponed to October 1, 1910, and was finally made on January 17, 1911.

On May 21, 1910, a supplemental bill of complaint was filed in the action instituted by Baldwin Locomotive Works and above referred to. In this supplemental bill there was a substantial repetition of the allegations of the original bill, but there were brought in as party defendants Mercantile Trust Company of San Francisco, the Trustee under the deed of trust, together with a number of bondholders, stockholders and creditors who had theretofore filed petitions in intervention in the action as originally brought. There was filed, as a part of the supplemental bill, an admission by the railway company that its allegations were true. On July 22, 1910, F. S. Stratton, as receiver, filed a petition in the cause, stating that the properties and railroad of the railway company could not be made to pay the expenses of operation; that Mercantile Trust Company of San Francisco had published the notice of sale above referred to, and praying, for this and other reasons, that the court authorized him to sell the said properties and railroad. An order to show cause why such sale should not be made was served on Mercantile Trust Company of San Francisco, as well as the other parties to the proceeding, and, in response thereto, the Trustee filed its "Special Appearance and Return", in which it prayed that the order to show cause be discharged and the petition of the receiver denied in so far as its allowance would interfere with or prevent the Trustee from

proceeding with the sale already advertised, and that the court make its order permitting it to proceed, in the exercise of the powers conferred upon it by the deed of trust, to sell the properties of the railway company. The petition of the receiver was heard on various days in August and September, 1910, and on the 17th of September, 1910, the court made its order directing Mercantile Trust Co. to sell the properties referred to on October 19, 1910 (Record, pp. 53-99). It was provided in this order that the sale, so directed to be had, should be made "subject to the payment of the several claims against said Ocean Shore Railway Company, which shall hereafter be determined to be entitled to priority of payment over the bonds in said deed of trust described." The sale was then postponed, but was finally held on January 17, 1911, pursuant to the order of the Circuit Court. At that sale the properties were sold by Mercantile Trust Company of San Francisco to C. C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and A. C. Kains, for the sum of \$1,035,000. This sale was on the application of Mercantile Trust Company of San Francisco, confirmed by the Circuit Court on January 31, 1911, and, on the same day, Mercantile Trust Company of San Francisco, in its own behalf and as attorney in fact for Ocean Shore Railway Company, and F. S. Stratton, as receiver of Ocean Shore Railway Company, executed their respective deeds conveying all their rights, titles and interests to the purchasers at the sale of January 17, 1911.

On May 8, 1911, A. C. Kains, one of the purchasers, conveyed all his interest in the properties to W. S. Martin, intervenor herein.

On May 12, 1911, C. C. Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and W. S. Martin filed their petition setting forth their interests in the properties so purchased, and praying that they be allowed to intervene in the action, and on May 25, 1911, their petition was granted by the Circuit Court, and since that order was made they have continued to be parties to the action.

Prior to the sale of the properties above referred to, and on the petition of the receiver, the court referred to the Honorable H. M. Wright, Standing Master in Chancery, the question as to the relative priorities of the various debts of Ocean Shore Railway Company as against the bond issue of that company, and, particularly, priorities as between the creditors of that company and Mercantile Trust Company of San Francisco, and the Master was directed to determine and report what claims of creditors, if any, were entitled to a payment and lien upon the properties of Ocean Shore Railway Company prior to and ahead of that of Mercantile Trust Company of San Francisco. The hearings were commenced on September 13, 1910, and conducted in accordance with the usual equity practice.

The evidence introduced showed, beside the facts already referred to, the following:

- (1) All those individuals whose names appear on Exhibit "A" of the record (pp. 41-48) performed, between June 1, 1909, and December 6, 1909, in the current, ordinary and normal operation of the railroad of Ocean Shore Railway Company, services

of a value equal to the amount set opposite the name of each claimant in Column 2 of said exhibit. These debts were such as would ordinarily have been paid out of the current income from operation, and their payment was not in any way secured.

- (2) All those individuals whose names appear on Exhibit "B" of the record (pp. 48-51) furnished to Ocean Shore Railway Company between June 1, 1909, and December 6, 1909, in the current, ordinary and normal operation of the railroad of that company, materials and supplies of a value equal to the amount set opposite the name of each claimant in column 2 of said exhibit. These debts were such as would ordinarily have been paid out of the current income from operation, and their payment was not in any way secured.
- (3) The labor performed by those persons whose names appear in Exhibit "A" and the material and supplies furnished by those persons whose names appear in Exhibit "B" were, in each instance, necessary to the business of Ocean Shore Railway Company as a carrier of freight and passengers, and to the public service, and were necessary for the maintenance of the railway property during the period from June 1, 1909, to December 6, 1909.
- (4) There were no funds in the treasury of Ocean Shore Railway Company on December 6, 1909, and there was no net income from the operation of the properties by the receiver.

- (5) There was diverted from the funds derived from the operation of the properties during the period from June 1, 1909, to December 6, 1909, the sum of \$30,000, that amount being devoted to the payment of expenses of construction, interest on construction charges, and other similar indebtedness, not incurred in the current operation of the railroad.
- (6) There was no evidence introduced as to the time or times at which the amount of \$30,000 was diverted, except that such diversion took place between June 1, 1909, and December 6, 1909; and there was also no evidence to show that such diversion, or any of it, occurred after any of the claims here considered accrued or became payable.
- (7) All those individuals whose names appear on Exhibit "C" (Rec. p. 51) were the owners of real property used by Ocean Shore Railway Company in the operation of its railroad prior to the appointment of the receiver on December 6, 1909. After the appointment these individuals demanded from the said receiver the payment of the amounts then due for the use of said properties, or that the said properties be returned to them. The court, upon motion of the receiver, thereupon directed the receiver to issue notes covering such indebtedness, said notes to bear interest at the rate of seven per cent. per annum. These notes were actually executed in the amounts set forth opposite the name of each claimant in column 2 of Exhibit "C", and were then delivered by the receiver to the individuals named in Exhibit "C",

and the receiver thereupon continued to use the said properties.

Upon these facts the Master determined, as more fully appears in his report, that

- (a) debts entitled to preference over the bonds were the current and ordinary debts of normal operation and maintenance, ordinarily and by reasonable expectation payable out of the current income from such operation, and accruing between June 1, 1909, and the date of the receiver's appointment, December 6, 1909;
- (b) such preference in payment was conditioned upon, and limited in amount by, the existence of a fund composed (1) of current income on hand at the receiver's appointment; (2) of net income of the receiver's operation, and (3) of the amount of current income of operation between June 1, 1909, and December 6, 1909, which was diverted from the payment of current and ordinary operating expenses to other purposes;
- (c) the amount of said preferred claims, set forth in detail, was \$48,571.42, and that the same were payable out of the proceeds of sale, pro rata, only to the extent of such diversion, viz., \$30,000, there being in fact no income on hand at the beginning of the receivership and no net income during the receivership;
- (d) whereas claimants whose names appear in Exhibits "A" and "B" of the record (pp. 41-51) performed services or furnished materials and sup-

plies of a value equal to that set opposite the name of each said claimant in column 1 of said exhibits, they were entitled to a lien upon the properties of Ocean Shore Railway Company only in the amounts set opposite their respective names in column 2 of said exhibits; and

- (e) claimants whose names appear on Exhibit "C" and whose claims were by the Circuit Court ordered paid during the receivership were entitled to payment of their claims in full.

It appears in the Agreed Statement (Rec. p. 33) that appellants herein duly excepted to the report of the Master on the ground that since neither the trustee, nor appellants, as the successors in interest of the trustee, had asked for the appointment of a receiver or taken any steps to secure said appointment, or invoked the assistance of a court of equity, their rights in the properties could not be diminished or postponed for the benefit of those in whose favor the Master had found; and furthermore that since there was no showing that the diversion found by the Master took place subsequent to the time at which any particular claimant's right to payment accrued, no priorities could be allowed to any claimant. The District Court, after argument, affirmed the said report in all respects, except that it determined that said claims set forth in Exhibits "A" and "B" were entitled to priority of payment, as against the purchasers of the properties, to the full amount of their several claims, irrespective of diversion of current income, and that the claims so considered should constitute a lien upon the properties in the hands of the

purchasers, and directing that those properties be sold to satisfy the claims if they were not paid by the purchasers.

Thereafter this appeal was prosecuted.

Specifications of Error.

Errors have been assigned in the record on appeal from the decree of the District Court.

The assignments of error will be discussed for convenience under the following specifications:

I.

The court erred in holding that the creditors of Ocean Shore Railway Company, whose names appear in Exhibits "A" and "B" (Record, pp. 41 to 51), and who performed labor for, or furnished materials to, that company during the six months before the appointment of the receiver, are entitled to the payment of their claims in full, and to a first lien prior to that of Mercantile Trust Company of San Francisco upon the properties of Ocean Shore Railway Company to secure such payment;

(a) Because the aggregate total of the claims thus allowed is \$48,571.42, whereas the diversion of current income of the company to the benefit of the bondholders during the six months' period was \$30,000;

(b) Because there is no evidence in the record that Ocean Shore Railway Company diverted any of its current income from operation to the payment of indebtedness, other than that of operation, after any claim al-

lowed priority matured and became payable (Assignment of Errors, I, II, III, V, VI, VII, IX, XI, XIII, XVI, XX, XXI, XXII, Record, pp. 132-141).

II.

The court erred in holding that the creditors of Ocean Shore Railway Company, whose names appear in Exhibits "A" and "B" (Record, pp. 41 to 51), and who performed labor for or furnished materials to that company, are entitled to the payment of their claims in full and to a first lien prior to that of Mercantile Trust Company of San Francisco upon the properties of Ocean Shore Railway Company to secure such payment because the proceeding in which the receiver was appointed was initiated by an unsecured creditor and Mercantile Trust Company of San Francisco did not invoke the aid of the court nor participate in nor consent to the appointment (Assignment of Errors IV, VIII, XVI, XVII, XVIII, XIX, XX, XXI, XXII, Record, pp. 132-141).

Our contentions will be based squarely upon the foregoing specifications, and we shall consider the errors assigned in the order in which they are set forth.

I.

"SIX MONTHS" LABOR AND SUPPLY CLAIMANTS CANNOT ENFORCE PRIORITY AGAINST THE CORPUS OF RAILROAD PROPERTY, UNLESS THERE HAS BEEN A DIVERSION OF CURRENT INCOME AFTER THE MATURITY OF THEIR CLAIMS.

We shall contend at some length in a subsequent portion of this brief that an unsecured creditor of an insolv-

ent railroad whose claim accrued prior to the appointment of a receiver cannot displace a previously vested mortgage lien to any extent or under any circumstances unless the trustee under the mortgage itself seeks and obtains the foreclosure of its mortgage and the appointment of a receiver and has thus subjected itself to the operation of the rule, that he who seeks equity must do equity. If that contention is sound the decree of the District Court in this case must be reversed with direction to disallow the claims of those creditors whose names appear in Exhibits "A" and "B" in their entirety. But in this subdivision of the brief, we shall concede, for the purposes of argument, that the manner in which the assistance of a court of equity is invoked, has no bearing on the determination of the priorities involved. We shall argue that the court erred in its determination and application of the other principles governing the allowance of priorities. Our contention here will be that, even conceding that some priorities are to be allowed in this case in spite of the fact that the mortgage trustee did not invoke the aid of the courts, the true rules to be applied are these:

In the foreclosure of a railroad mortgage prereceiver-ship debts incurred within six months preceding the appointment of a receiver may not be paid out of the corpus of the property in priority to the bonded indebtedness;

(1) Unless current income from operation during that period has been diverted from the payment of operating expenses to the benefit of the mortgagee, and then only to the extent of the diversion, or

(2) Unless the payment of such claims is indispensable to the continued operation of the property and the preservation of the trust "*res*"—the railroad property.

We shall contend further that when such claims are to be given priority because there has been a diversion of income, it must appear in addition that the debts were incurred prior to the diversion.

The bearing of these contentions on the present appeal is obvious from the statement of facts already set forth. It is not argued by appellees that the *payment* of any of the claims set forth in Exhibits "A" and "B" was indispensable to the continued operation of the property or the preservation of the trust *res*. Consequently, if our contention is sound, the allowance of priority must depend on the diversion of income and be limited to the extent to which such income was diverted. The decree must, therefore, in any event be modified and the claims cut down to their respective proportions of \$30,000. And if we are correct in arguing that it is necessary also that the diversion must have been subsequent to the time at which the debts were incurred, the decree in so far as claimants whose names appear on Exhibits "A" and "B" are concerned must be reversed altogether, for there was no evidence that there was any diversion after the company had incurred the debts in question.

To a consideration of these questions, a brief review of the law governing the rights of railroad mortgagees is necessary.

In form, railroad mortgages customarily cover both the corpus of the property and the income from its opera-

tion, and if the trust deed were literally enforced the trustee could resort to either fund to satisfy the indebtedness of the mortgagor. Courts of equity, however, have frequently determined that where a mortgage does cover income as well as corpus, the trustee's lien on income does not attach until it takes the necessary steps to reduce it to possession according to the terms of the mortgage, as by demand and entry after default, or by receivership foreclosure proceedings. The rule, thus applied, is not peculiar to railroad mortgages, but is a part of the general law of mortgages in which income forms a portion of the security. At any time before the mortgagee attempts to reduce it to possession income on hand may, notwithstanding the existence of the prior lien, be reached by execution at the suit of any creditor.

Galveston R. R. Co. v. Cowdrey, 11 Wall. 459;

Freedman's Savings Co. v. Shepherd, 127 U. S. 494;

Sage v. Memphis Ry. Co., 125 U. S. 361.

When the mortgagor is a railroad, income is even more available for the payment of the claims of unsecured creditors, and courts to whose care railroad property has been committed in a receivership proceeding have determined that, because of the unusual character of the property, the necessity that it be kept in operation, the fact that the payment of its current expenses is often necessarily delayed, income which may be on hand at the time of the appointment, or which may accrue during operation by the receiver, shall be applied to the payment of "debts of the income" before the trustee may resort thereto.

The courts to reach this result imply an agreement on the part of the mortgagee that notwithstanding his unambiguous contract regarding the priority of his lien on income, it is net income after the payment of operating expenses, which it is intended shall be covered, not gross receipts. It follows from this judicial construction of the mortgage that since a mortgagee is not entitled to resort to income until expenses of operation are paid, he will be forced by a court of equity, whose aid he has invoked, to account for income and the purposes for which it has been used. If income upon which he had no lien and which should have been used by the mortgagor to pay matured operating indebtedness, has been devoted to paying interest on the bonded debt or debts of construction, a court of equity will require a mortgagee who asks its assistance, to restore to creditors from the proceeds of sale the amounts expended for such purposes. It is considered equitable that the mortgagee should reimburse those at whose expense it has gained.

This, then, is the doctrine of diversion: That where, either during the receivership itself, or during a limited period preceding the appointment of a receiver, usually, and in this case taken to be six months, current income from operation has been diverted from its normal use—the payment of operating expenses—to the satisfaction of the mortgage debt or to the payment of construction charges, or to the acquisition of improvements or betterments which have increased the security of the bondholders, the mortgagee will be forced to restore, for the benefit of creditors, that which should, primarily, have been devoted to the payment of their claims.

Thus far we may, we believe, fairly say that there is no disagreement between counsel for appellees and ourselves. To our next contention, that a claimant cannot displace a mortgagee's lien and resort to the property itself for payment before the bonded indebtedness is paid, *unless* a diversion of income is shown to have occurred, there is, however, strenuous objection.

It is claimed by appellees that, whereas diversion of income is one ground for the allowance of priorities, those who furnish labor or materials necessary to the ordinary and normal operation of a railroad, prior to the appointment of a receiver, may enforce the prior payment of their claims from the proceeds of sale, *irrespective of a diversion*. It is our contention that claimants can only require such payment when they are able to show that current income has been diverted. We make no exception to the rule, thus stated, that claimants may only enforce such payment when a diversion is shown, because we believe that it is only under these circumstances that claimants themselves have any equities which compel a court to allow them priority. We admit, however, that there is another case in which such claims may properly be ordered paid by the court even though there has been no diversion, the case, namely, where without their payment the continued operation of the property will be jeopardized. This exception is based on the right and duty of the court to preserve the property, not on the equity of claimants. If, for instance, the operating force of the railroad refuses to continue its employment unless back wages are paid, if connecting lines refuse a continuation of service unless

traffic balances are paid, if other railroads threaten to cancel existing leases unless past due rentals are paid, the court may order that such payments be made. The preservation of the property demands it. The exception here considered has no reference to any equity of the person who may, in fact, be paid. It is in no way related to the doctrine of income. It has no connection with the rule of diversion. It is, in the last analysis, but the enforcement of the principle governing railroad receiverships—"the road will be kept in operation at the cost of the property, if necessary". The preservation of the trust "*res*", not the equities of claimants, is the test.

This exception is from one point of view of no importance in the present case so far as claimants whose names appear on Exhibits "A" and "B" are concerned, for it is not claimed here that the payment of any of those debts was necessary to the preservation of the "*res*." From another point of view it is of very considerable importance because we believe that the cases which are relied on by appellees, as establishing the principle for which they contend, are all cases coming within this exception.

The point of difference between counsel for appellees and ourselves is, therefore, this:

We claim that prereceivership debts will only be allowed priority at the instance of claimants when a diversion is shown to have occurred, although we concede that if, after the appointment, the preservation of the trust property requires that payment of such indebtedness be made, the court may properly order that it be paid.

Appellees, on the other hand, assert that claimants are entitled to priority of payment regardless of diversion, or the necessity of payment from the point of view of the court and the receiver, if the labor performed or the materials furnished contributed to keep the railroad a going concern. They rely upon certain decisions of the Supreme Court, two decisions of the Circuit Court, the first rendered by Mr. Justice McKenna, at that time on the Circuit bench, the second by Judge Morrow, and upon a decision of this court, the opinion in which was written by Judge Morrow. We shall show that the Supreme Court cases from the earliest case of

Fosdick v. Schall, 99 U. S. 235; 25 L. Ed. 339,
to the latest case of

Gregg v. Metropolitan Trust Company, 197 U. S.
183,

follow the rule for which we contend, that every Circuit Court of Appeals, except that of the Ninth Circuit, which has had occasion to consider the question, has adopted the same rule and that the principle as laid down in this circuit in

New York Guaranty Co. v. Tacoma Ry. Co., 83
Fed. 365,

resulted from what Mr. Justice Holmes, when referring to other Federal cases similarly decided, called the "application of an erroneous impression."

We shall first examine what are unanimously conceded to be the more important Supreme Court cases, following, in so far as brevity will permit, the very careful analysis of those cases by the Master, shall then turn to the

rule of the various circuits, other than the Ninth, and shall finally consider the cases decided by Judge McKenna and Judge Morrow above referred to.

That the court may have what we believe to be the true rule definitely in mind before we enter upon a discussion of the cases, we may, we think, accurately state it as follows:

Prereceivership unsecured debts, arising within a limited time before the appointment of a receiver, will be paid out of such income as may be on hand when the receiver is appointed, or may accrue during the receivership; or, if these funds are insufficient, out of the proceeds of sale of the property to the extent, but only to the extent, that income has been diverted to the benefit of the mortgagee during the period preceding the appointment, or during the receivership itself. If, however, a court finds it necessary to pay prior debts to keep the road a going concern, payments thus made or certificates issued to secure such payments will be allowed and approved.

We now proceed to an examination of the cases:

The case most often referred to in the reports, and the one in which the doctrine of priority was first carefully considered, is

Fosdick v. Schall, 99 U. S. 235; 25 L. Ed. 343
(1879),

the opinion in which was delivered by Mr. Justice Waite. The case was commenced by bondholders who filed suit for foreclosure in the state court and obtained the appointment of a receiver. The trustees later filing their

bill for foreclosure in the Circuit Court, the cause was removed to that court and a new receiver was appointed. Prior to either receivership Schall had delivered certain cars to the railroad company under an agreement of conditional sale, reserving title in himself. The cars had not been paid for, but had been used by both receivers and a monthly rental paid for their use. The trustees claimed title under their mortgage, but the lower court held that Schall had not parted with his title, directed the return of the cars to him, and ordered that, out of the proceeds of sale of the properties, he should be paid at the agreed rental for a period of six months prior to the first receivership in the state court and for the period the cars were used by the receiver of the state court. The Supreme Court decided that Schall had not parted with title, and might reclaim the cars. It was in its discussion of the order directing the payment of rentals out of the fund derived from sale of property that the Supreme Court found occasion to announce its views upon allowance of priorities in language quoted in every case since decided:

“Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the moment something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the court from the future current receipts

before anything derived from that source goes to the mortgagees. In this way the court will only do what, if a receiver should not be appointed, the company ought itself to do. For even though the mortgage may in terms give a lien upon the profits and income, until possession of the mortgaged premises is actually taken or something equivalent done, the whole earnings belong to the company and are subject to its control. *R. R. Co. v. Cowdrey*, 11 Wall., 459, 20 L. Ed. 199; *Gilman v. Telegraph Co.*, 91 U. S. 603, 23 L. Ed. 405; *Amer. Br. Co. v. Heidelbach*, 94 U. S. 798, 24 L. Ed. 144.

“The mortgagee has his strict rights which he may enforce in the ordinary way. If he asks no favors, he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases and do equity in order to get equity. * * * it is within the power of the court to use the income of the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business. This, not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own hands as, if practicable, to restore the parties to their original equitable rights. While, ordinarily, this power is confined to the appropriation of the income of the receivership and the proceeds of moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way. Thus it often happens that, in the

course of the administration of the cause, the court is called upon to take income which would otherwise be applied to the payment of old debts for current expenses, and use it to make permanent improvements on the fixed property, or to buy additional equipment. In this way the value of the mortgaged property is not infrequently materially increased.

* * * * *

“The power rests upon the fact that, in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. *It follows that if there has been in reality no diversion, there can be no restoration; and that the amount of restoration should be made to depend upon the amount of the diversion.*”

In this case, it should be noted, the court determines

- (1) that the current debts of operation should be paid from the income from operation;
- (2) that, if not so paid, they may be met out of the income of the receivership;
- (3) that, if income is not used for this purpose, but is employed to increase the security of the mortgage, equity will require that there be a restoration to the current debt fund of that which has been inequitably withdrawn;
- (4) that the entire doctrine is based upon the equitable principle that “he who seeks equity must do equity.”

The cases of

Huydekoper v. The Hinckley Locomotive Wks.,
99 U. S. 258 (1879);

Hale v. Frost, 99 U. S. 389 (1879);

Barton v. Barbour, 104 U. S. 126 (1881),

follow, without deviation, the rules laid down in *Fosdick v. Schall*, and add nothing to the principles there announced.

The next case decided by the Supreme Court which considered this subject was

Miltenberger v. Logansport Ry. Co., 106 U. S.
286 (1882).

The contention of appellees that this case is authority for the allowance of preferred claims, regardless of diversion of income, and the fact that it is conceded to be one of the leading cases upon the subject of priorities, justifies a detailed statement of facts. In 1870 the railroad executed a first mortgage to the Fidelity Insurance, Trust and Safe Deposit Company, as trustee, covering all property then owned or thereafter to be acquired by it. On November 1, 1873, it failed to pay the interest on its bonds. On January 1, 1873, the railroad executed to Farmers' Loan and Trust Company, as trustee, a second mortgage covering all present and after-acquired property, but defaulted in its interest due on January 1, 1874, and July 1, 1874. On August 26, 1874, the second mortgagee filed in the Circuit Court of the United States a bill for the foreclosure of the second mortgage, joining as parties the mortgagor, the trustee and certain judgment creditors, praying foreclosure of the rights of the mortgagor and judgment creditors, a sale and a

receivership. On the same day the railroad company filed its answer admitting the allegations of the bill and consenting to the relief demanded, and the court, on that day, made its order requiring the first mortgagee to appear and plead on or before a certain fixed date. It also appointed a receiver, and, by the order, empowered him to operate and maintain the road, receive its revenue, pay its operating expenses, make repairs and manage its entire business, and to pay, out of income, the arrears due for operating expenses for a period in the past not exceeding ninety days. On September 9, 1874, the receiver filed his petition, stating a deficiency of rolling stock and the necessity of purchasing additional equipment; that the company was in debt to other and connecting lines of road; that a part of said indebtedness was incurred more than ninety days prior to the order appointing the receiver, but "that the *payment* of that class of claims was indispensable to the business of the road, and that it would suffer great detriment unless he was authorized to provide for such payment at once." On October 3, 1874, the court made its order empowering the receiver to buy additional rolling stock and pay the indebtedness to other and connecting lines, for the purposes set forth in the petition, notwithstanding the limitation of ninety days, and to expend thirty thousand dollars in the completion of additional roadbed. On November 3, 1874, the first mortgagee filed its answer admitting the embarrassment of the road, but denying that the appointment of a receiver would relieve that embarrassment, and alleging that it would be unjust to the holders of first mortgage bonds, and that no

order should be made which would impair the rights of such bondholders. No further proceedings in court took place for eleven months. In October, 1875, the receiver filed a report showing his indebtedness, in the execution of the court's order, for expenditures for the construction of new road, purchase of rolling stock, taxes, rights of way, "back pay and supplies in operating the road, rentals for leased lines and rolling stock," and asked leave to borrow a sum of money on receiver's certificates made a first lien on the property "as for the best interests of the trust property." The court made its order on the same day, stating "that there was danger of losing the property by reason of the forfeiture of the contract under which the same had been purchased unless provision was made for the payment of the same"; that a sum was due for the construction of the road previously authorized; "that there were the said amounts due for taxes and rights of way, back pay and supplies," that these sums could not be provided for out of current receipts of the road, and authorized the issuance of receiver's certificates, payable out of income of the road, "which certificates are to be provided for by this court in its final order in said cause unless paid by the receiver out of the income of said road, as aforesaid." On November 27, 1875, the holders of first mortgage bonds appearing in behalf of themselves and all other holders of such bonds, were made parties-defendant in their petition, and were given leave to file an answer and cross-bill. Their cross-bill stated that the income of the road over actual operating expenses and repairs was about twenty thousand dollars, and that

there had been a deficit because of the payment of extraordinary expenses; and the petition prayed for the sale of the mortgaged property to pay the first mortgage bonds, and the appointment of a new receiver, in place of the receiver then in possession. In May, 1876, the trustee under the first mortgage filed an answer to the cross-bill, as had the second mortgagee and the mortgagor. In May, 1876, the original suit and the cross suit were brought to hearing, and consolidated, and a decree rendered, such decree, however, reserving all questions of priority of liens and declaring that it was not necessary to pass on said claims before a sale was had. In July, 1876, a joint receiver was appointed with the original receiver. On January 22, 1879, the court made its order allowing certain claims to be paid out of the funds in the possession of the court, as well from the income from the road as from the proceeds of any sale hereafter made, the court reserving to the mortgagees the right to object thereto. In July, 1879, the court ordered the road sold as an entirety by the Master, who was directed to pay, out of the net proceeds of the sale, costs of suit and allowances to trustees and solicitors, taxes, claims against the receivership, and the fund in court allowed by the order of January 22, 1879, certain other allowed claims, and all other claims against the receivership and funds which might thereafter be allowed. It was then provided that the first mortgage bonds should be paid and the balance as the court might direct. An appeal was taken by the cross-complainants from this order. Upon the appeal, all the orders allowing the priorities were objected to. The court said:

“In respect to the \$10,000.00 due other and connecting lines of road for materials and repairs and for ticket and freight balances, a part of which was stated was incurred more than ninety days before the 26th of August, 1874, the first petition stated that payment of that class of claims was indispensable to the business of the road and that unless the receiver was authorized to provide for them at once the business of the road would suffer great detriment. These reasons were satisfactory to the court. In the examination by the master, of the accounts of the receiver, evidence was taken as to the payment by him of items due, when he took possession, for operating expenses, and of moneys due other and connecting lines for the matters named. The report of the master shows that he disallowed several items in the receiver's accounts, claimed under the above heads, where the claims were made on the ground that the creditors threatened not to furnish any more supplies on credit unless they were paid the arrears. His action, sanctioned by the court, in allowing items within the scope of the orders of the court appears to have been careful, discriminating and judicious, so far as the facts can be arrived at from the record. It cannot be affirmed that no items which accrued before the appointment of a receiver can be allowed in any case. Many circumstances may exist *which may make it necessary and indispensable to the business of the road and the preservation of the property*, for the receiver to *pay* pre-existing debts of certain classes out of the *earnings* of the receivership, or *even the corpus* of the property, under the order of the court, with a priority of lien. Yet the discretion to do so should be exercised with very great care. The *payment* of such debts stands, *prima facie*, on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of

the latter by special circumstances. It is easy to see that the *payment* of unpaid debts for operating expenses, accrued within ninety days, due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from work simultaneously is to be deprecated, in the interests both of the property and of the public, and the *payment* of limited amounts due to other and connecting lines of road for materials and repairs and for unpaid ticket and freight balances, the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result, *in case of non-payment* the general consequence involving largely, also, the interests and accommodation of travel and traffic, may well place *such payments* in the category of payments to preserve the mortgaged property in a large sense, by maintaining the good will and integrity of the enterprise, and entitle them to be made a first lien. This view of the public interest, in such a highway for public use as a railroad is, as bearing on the maintenance and use of its franchises and property in the hands of a receiver, with a view to public convenience, was the subject of approval by this court, speaking through Mr. Justice Woods, in *Barton v. Barbour*, 104 U. S. 126 (XXVI., 672). The appellants furnish no basis for questioning any specific amounts allowed in respect of the arrears referred to, but object to the allowance of anything out of the sale of the corpus for such expenditures. Under all the circumstances of this case, we see no valid objection to the provisions of the orders complained of." (Italics our own.)

It must, we think, be conceded, that this case is not, in any way, authority for the contention of appellees that labor and materialmen are in any event, and

regardless of diversion, entitled to payment from the corpus of the fund. The Master's analysis of the case is, it seems to us, accurate and we cannot improve upon it. He says (p. 20):

“On this I observe that while the appellants are stated by the court as questioning the orders of August 26th, 1874, appointing the receiver, and so far as it empowered him to pay arrears for operating expenses within ninety days, the court says nothing about this order in terms, but after discussing the doctrine of *Wallace vs. Loomis* mentions specifically the subsequent order of October 3, 1874. It is true that most of the discussion in the opinion related specifically to amounts due to connecting lines, but it is specifically shown that the master's examination of the receiver's account was on the point of the *necessity of payment* by the receiver of items due for operating expenses when he took possession. The opinion further points out that the master disallowed several items paid by the receiver, even where the claims were made on the ground that no further supplies would be furnished unless arrears were paid. In the opinion of the Supreme Court, then, even this fact would not always justify payment by the receiver. The opinion then continues:

“‘It cannot be affirmed that no items which accrued before the appointment of the receiver *can be allowed* in any case.’

“A careful reading will show that the court is not considering the allowance of *priority* but the allowance to the receiver of *payments* which he has made. In the rest of the quotation it will also be observed that what the court is talking about is *the necessity of payment* by the receiver, and the opinion explains why under the theory of *Wallace vs. Loomis*, while the payment of such pre-existing debts stands, *prima facie*, on a different basis from the payment of claims arising under a receivership,

the necessities of continued operation of the road under the receivership may justify the action of the receiver in paying them and of the court in making the payment a first lien on the property. I therefore conclude that payments made under the order allowing the receiver to pay pre-existing operating expenses were the subject of specific consideration by the Supreme Court, and secondly, that justification of their payment must be based not on any inherent right to payment, but upon considerations of imperious necessity arising during the receivership and making it necessary for him to pay them so as to keep the road operating. This is the view taken by Mr. Justice Holmes in *Gregg vs. Metropolitan Trust Company*, 197 U. S., which will be subsequently considered. Thus, the scarcity of labor and the possibility that he may lose his operating force unless arrearages are paid may justify the receiver in keeping his force together by paying arrearages, and his payments will be approved and made a first lien. So, it may be imagined, that the continuance of a favorable contract for supplies at a price lower than those prevailing might justify the receiver in exceptional cases in paying back debts and the court in preferring them. So of the illustrations given by the Supreme Court. The case goes no further."

* * * * *

"The case may be regarded as deciding nothing more than that receivership debts will be made a first lien; that pre-existing debts if paid by the receiver on the ground of pressing necessity may be allowed him in his accounts and (*semble*) receiver's certificate issued to obtain funds for that purpose will be allowed as a first lien. It does not decide that if pre-existing labor or supply claims are not paid and no necessity arises for securing their payments by receiver's certificates that they will be paid at a later stage of the litigation by reason of any inherent equity."

It should be remembered that the Supreme Court in the later cases of

St. Louis R. R. Co. v. Cleveland R. R. Co., 125 U. S. 658; 31 L. Ed. 837 (1888),

and in

Gregg v. Mercantile Trust Co., 197 U. S. 183; 49 L. Ed. 717,

held that in the *Miltenberger* case and in the *Illinois Midland* case, later considered, a diversion had been found, and we suggest that the later cases would not have so emphasized its existence had they not admitted its importance. Bearing in mind, then, that, in any event, the Supreme Court has determined that a diversion existed in the *Miltenberger* case, we submit that the doctrine of that case may be accurately stated as follows:

(1) Certain debts, incurred before the appointment of a receiver may be allowed priority out of either income or corpus.

(2) Such payments may be made out of income, regardless of diversion and regardless of whether the income accrued prior to or during the receivership.

(3) Such payments will only be made out of the corpus of the fund when special circumstances exist.

(4) These special circumstances must consist either (a) in proof of a diversion of current income which should have gone to the payment of general creditors; or, (b) in a showing that the nonpayment of certain

indebtedness incurred prior to the appointment of the receiver would result in the destruction of the road.

The considerations thus sanctioned by Mr. Justice Blatchford are two, and two only: the first, that where a diversion has been discovered, equity and good conscience will require that that which has been improperly taken shall be restored; the second, the necessity from the point of view of all parties interested that the road be kept running. The only circumstances suggested in the *Miltenberger* case which will warrant the imposition of a lien prior to that of the trustee, in the absence of diversion, is the *necessity for payment*; if the preservation of the property does not require payment an allowance would be improper. The claimant has no equity when this ground for payment is assigned, but the payment is made because the protection of the trust *res* demands it. Payments so made and priorities based on diversion of current income are distinct, unrelated and grounded on different principles, the claimant only being able to himself assert his right to preferential payment when a diversion is shown, although he may be fortunate enough to be paid out of the corpus of the fund if the payment of his debt is necessary to keep the road running. We shall later show that the Master's construction of the *Miltenberger* case is consistent with the decisions in the *Union Trust* case and in the *Gregg* case, and is, in fact, the construction which Mr. Justice Holmes in the latter case insists upon. We also suggest that, even though in the *Miltenberger* case the receiver was, at his appointment, given the power to

make certain necessary payments, the court plainly draws a distinction between the permission to make necessary payments and an order to pay certain indebtedness, and holds that, unless certain payments are made, through pressure and necessity, it was proved that they were not necessary to keep the road running, and, hence, were not properly met out of the corpus of the property. The case, in other words, refers to the duty of a court of equity to protect a trust *res* in its hands; it does not deal with the rights of claimants to enforce the payment of their claims from the corpus of the fund.

In

Union Trust Co. v. Souther, 107 U. S. 591 (1883), a receiver, appointed in a foreclosure proceeding, was directed to pay *out of net income* of the receivership all amounts due and owing by a railroad company for labor and supplies that might have accrued in the operation and maintenance of such railroad property within six months immediately preceding the rendition of the decree. During the receivership the net earnings of the road exceeded \$200,000. This amount was, however, expended in permanent improvements and in purchasing rolling stock and real estate, and a large proportion of the six months' labor and supply claims were unpaid. The court held that there had been a diversion by the receiver, and that the income of the receivership, belonging as it did in equity to the labor and supply claimants, should have been devoted to the payment of those claimants, and

that, since it was used for purposes which increased the security of the mortgagee, the latter should be forced to restore, for the benefit of creditors, that which it had withdrawn. The case clearly follows the doctrine announced in *Fosdick v. Schall*, supra, and the rule for which we are contending.

In

Union Trust Co. v. Walker, 107 U. S. 596 (1883), the same court, speaking through Mr. Justice Waite, once more affirmed the doctrine of *Fosdick v. Schall*, supra.

In

Burnham v. Bowen, 111 U. S. 776 (1884), the opinion was once more written by Chief Justice Waite. A mortgage of railroad property had been given by Burnham and others in 1871, but no interest was paid upon the bonds. The company remained in possession and operated the road until January, 1875, when the trustees brought suit in a state court for foreclosure of the mortgage and the appointment of a receiver. No special provision was made in the order appointing the receiver for the payment of debts then owing for current expenses. The claim of Bowen arose on account of coal furnished to the railroad company during the year 1874 for locomotive use. The case was thereafter removed to the Circuit Court of the United States, and another receiver appointed. Under orders from the latter court, the receiver paid from his earnings, which amounted to more than twenty-five thousand dollars, eight thousand dollars

in satisfaction of a suit for the foreclosure upon lands occupied by a depot and office, and fifteen thousand dollars on judgments for right of way. The court later gave a decree in favor of Bowen and created a lien in his favor on the property of the railroad in the hands of the trustees under the decree of foreclosure, and provided for a sale if the claim was not paid. The trustees appealed. The court said:

“It is said, however, that as no part of the income, before the appointment of the receiver, was used to pay mortgage interest or to put permanent improvements on the property or to increase the equipment, there was no such diversion of the funds, belonging in equity to the labor and supply creditors, as to make it proper to use the income of the receivership to pay them. The debt due Bowen was incurred to keep the road running, and thus preserve the security of the bond creditors. If the Trustees had taken possession under the mortgage, they would have been subjected to similar expenses to do what the company, with their consent and approbation, was doing for them. There is nothing to show that the receiver was appointed because of any misappropriation of the earnings by the company. On the contrary, it is probable, from the fact that the large judgment for the right of way was obtained about the same time the receiver was appointed, that the change of possession was effected to avoid anticipated embarrassments from that cause. But, however that may be, there certainly is no complaint of a diversion by the company of the current earnings from the payment of the current expenses. So far as anything appears on the record, the failure of the company to pay the debt to Bowen was due alone to the fact that the expenses of running the road and preserving the security of the bondholders were

greater than the receipts from the business. Under these circumstances, we think the debt was a charge in equity on the continuing income, as well that which came into the hands of the court after the receiver was appointed as that before. When, therefore, the court took the earnings of the receivership and applied them to the payment of the fixed charges on the railroad structures, thus increasing the security of the bondholders at the expense of the labor and supply creditors, there was such a diversion of what is denominated in *Fosdick v. Schall*, the 'current debt fund,' as to make it proper to require the mortgagees to pay it back. So far as current expense creditors are concerned, the court should use the income of the receivership in the way the company would have been bound in equity and good conscience to use it if no change in the possession had been made. This rule is in strict accordance with the decision in *Fosdick v. Schall*, which we see no reason to modify in any particular. * * *

"We do not now hold any more than we did in *Fosdick v. Schall*, or *Huidekoper v. Locomotive Works*, 99 U. S. 260, that the income of a railroad in the hands of a receiver, for the benefit of mortgage creditors who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road. All we then decided, and all we now decide, is that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use."

This case requires no comment other than that it follows *Fosdick v. Schall* with unrestricted approval, and specifically repeats the rule which the Supreme Court has followed from the first to the last of its decisions.

The case of

Union Trust Co. v. Illinois Midland Ry. Co., 117

U. S. 434,

was decided in 1886, the opinion being written by Mr. Justice Blatchford. In 1875, suit was brought in the state court of Illinois by one Hervey, a stockholder owning a majority of the stock of the constituent corporations of the Illinois Midland Railway Company and by two judgment creditors of one of the constituent companies with executions returned unsatisfied, a receivership and the marshaling and payment of all claims against the company being sought. The railroad appeared on the same day, and submitted to the order of the court, and a receiver was thereupon appointed. In the order of appointment the receiver was directed to pay out of the moneys that should come into his hands from the operation of the railroad his current expenses, sums due or to become due to connecting lines from interchange of business or contract service, taxes, and all amounts due to operatives and employees, rendered within six months prior to his appointment; all amounts due for supplies purchased and used in operating the railroad during that period and for supplies furnished to laborers and credited against their labor, and such amounts as might be due for rentals of rolling stock. On October 16, 1875, an amended bill brought in as plaintiffs Waring Brothers, owners of stocks and bonds, and numerous other creditors of the various constituent corporations. Later trustees of certain mortgages covering the properties of the constituent

companies became parties defendant. In September, 1877, the Union Trust Company, trustee under three different mortgages, was admitted as a party defendant. In February, 1878, the Union Trust Company filed its bills in the United States Circuit Court to foreclose various mortgages against the defendant and its constituent companies, and the stockholders' suit was removed to the United States Circuit Court and the various causes consolidated. The Federal court appointed its receiver, in place of the prior receiver, in December, 1878. A reference was ordered on the receiver's report to examine into certain matters relating to the issuance of receiver's certificates. Mr. Justice Harlan, in June, 1885, sitting in the Circuit Court, made a final decree disposing of various litigated questions and providing for the sale of the mortgaged property and distribution of the proceeds. The trustee and various bondholders appealed. The chief question of the appeal involved the priority awarded to sixteen receiver's certificates. Most of these certificates were issued for expenses of the receivership and to that extent the case is not in point as regards the question here considered, their allowance being plainly proper. The court, however, referred to the trust deed relied upon by the Paris and Decatur bondholders as warranting the issuance of all receiver's certificates considered in the opinion, saying:

“The strenuous contention on the part of the Paris and Decatur bondholders is that a court of chancery had no power, by a receiver and without their consent, to create, on the *corpus* of the

property, any lien taking priority over the mortgage lien. But these bondholders were represented by their trustee, the Union Trust Company. It filed a bill in the federal court as early as December, 1876, to foreclose the Paris and Decatur mortgage; and it was made a party, on its own petition, to the suit in the state court, in September, 1877. The Paris and Decatur mortgage provided that in case of default for six months in paying interest on the bonds (and such default occurred at latest on January 1, 1876, and the six months expired July 1, 1876, more than three months before any order was made on which any of the certificates were issued), all the bonds should become due and the lien might be enforced, and the trustee might enter on the property and operate it till sold, and make all needful repairs and replacements, and such useful alterations, additions and improvements to the road as might be necessary for its proper working, and pay for them out of the income; and also that in case of a default so continuing, the trustee might foreclose the mortgage by legal proceedings or sell the property by public auction; and should, *in case of such sale, deduct from the proceeds all expenses incurred in operating, managing or maintaining the road or in managing its business, and thereafter apply the proceeds to pay the bonds.* In the face of these provisions of the mortgage under which the bonds are held, and of the facts before recited as to the negligence of the trustee all the while the property was in the hands of the court, it does not at all comport with the principles of equity for the bondholders now to insist that the want of affirmative consent by them or their trustee could paralyze the arm of the court in the discharge of its duty. The want of that aid which it was the duty of the trustee and the bondholders to give to the court in discharging its responsible functions, with the road openly in charge of the receiver and being run by him, and

his acts plain to view, and the interest on the bonds in arrear, cannot be urged to a court of equity as a ground for denying its power to do what was thought by it best for the interests of all concerned, including even those who thus willfully stood aloof."

After disposing of certificates covering indebtedness of the receivership, the court turned to the provisions of the final decree which gave priority to six items, those numbered 1 to 5 being for expenses of the receivership, not requiring further consideration here, and number 6 being as follows:

"Amount of wages due employees of the Illinois Midland Company within six months immediately preceding the appointment of the first receiver."

In discussing the portion of the decree covering all six of the items appealed from, the court said:

"As to items 1, 2, 3, 4 and 5: while it is admitted that these debts were incurred for the ordinary expenses of the receivers in operating the road, it is contended that they are entitled to priority only out of the income of the road, and not out of the proceeds of the property itself. Of course, such items are payable out of income, if any, before the corpus is resorted to, but that may be resorted to when the items are proper ones to be allowed for operating expenses, after scrutiny and opportunity for those opposing to be heard."

Item six, it will be observed, is not referred to or mentioned, and it is at no place given special discussion. The claim was, however, allowed, the court, referring to the order in which receivers were appointed, saying:

“The terms of these orders do not impair or exclude the *ample authority* which the court would otherwise have, and otherwise has, to order the *claims in question* to be paid out of the property itself, with priority.

“The claims embraced in the six items have been carefully scrutinized and reported on favorably by the commissioner, and allowed by the circuit court, within and in accordance with the principles above laid down, and we think that all of them, including the ‘six months’ labor claims’ were properly allowed.”

The court later approved the action of the lower court in not giving preference over the bonds to claims called “six months’ supply claims”, the lower court having made no order for their payment, and closed with the following declaration:

“We are of opinion that (with the exception of debts for taxes and receivers’ certificates issued to borrow money to pay taxes or to discharge tax liens) there should be no priority or preference, among the debts and claims, whether receivers’ certificates or other debts, which are allowed precedence over the mortgage bonds of any road; but that all should stand alike, notwithstanding any orders heretofore made, and that the decree should so provide.”

In this case it is to be noted:

(1) That it was provided in the trust deed in case the property was sold by the trustee the bonds should not be paid until all expenses incurred in operating, managing or maintaining the road, or in managing the business, had been met, thus specifically authorizing, as the court found, the payment of laborers’ claims, which were finally allowed.

(2) As was later pointed out in the cases of *St. Louis etc. Co. v. Cleveland etc. Co.* and *Gregg v. Mercantile Trust Company*, a diversion was found in this case which, of itself, warranted the order, as made.

(3) The payment is stated by the court to have been made in accordance with the principle announced in the *Miltenberger* case.

(4) There can be no preference or priority among themselves of debts entitled to priority, labor and supply claimants being required to share equally in any fund to which they may be held entitled to resort.

The case of

Porter v. Pittsburg Bessemer Steel Co., 120 U. S. 649 (1887),

deals only with the rule governing priority of claims for construction, and is not in point here.

Penn v. Calhoun, 121 U. S. 251,

decided in 1887, is interesting as approving the doctrine of the earlier cases, but sheds no additional light on the questions here presented.

Sage v. Memphis and Little Rock R. R. Co., 125 U. S. 361 (1888),

deals only with the appointment of a receiver at the instance of a judgment creditor, without execution returned unsatisfied, and does not discuss the question of the priority of six months' operating claims.

In

Union Trust Co. v. Morrison, 125 U. S. 591 (1888), priority is allowed against the proceeds of sale because

a diversion was shown, the decision being squarely rested on *Fosdick v. Schall*, supra, *Miltenberger v. Logansport Ry. Co.*, supra, and *Union Trust Co. v. Illinois Midland Ry. Co.*, supra.

We next cite

St. Louis A. & T. H. R. R. Co. v. Cleveland C. C. & I. Ry. Co., 125 U. S. 658 (1888).

The case is worthy of note for two reasons: first, because it declares that priority will be allowed only upon income or against the proceeds of sale in case of a diversion of income; and, second, for its statement that the cases cited in the opinion, including the *Miltenberger* case and the *Illinois Midland* case, were instances where diversion had been shown. This statement is referred to as an authority, and approved, by Justice Holmes in the *Gregg* case, as will be hereafter noted. We quote as follows from the opinion (pp. 673-674):

“There are cases, it is true, where, owing to special circumstances, an equity arises in favor of certain classes of creditors of an insolvent railroad corporation, otherwise unsecured, by which they are entitled to outrank in priority of payment, even upon a distribution of the proceeds of a sale of the body of the property, those who are secured by prior mortgage liens. Illustrations and instances of these cases are to be found in *Fosdick v. Schall*, 99 U. S. 235; *Miltenberger v. Logansport C. & S. W. R. Co.*, 106 U. S. 286; *Union Trust Co. v. Souther*, 107 U. S. 591; *Burnham v. Bowen*, 111 U. S. 776; *Union Trust Co. v. Illinois Midland R. Co.*, 117 U. S. 434; *Dow v. Memphis & L. R. R. Co.*, 124 U. S. 652; *Sage v. Memphis & L. R. R. Co.*, 125 U. S. 361; and *Union Trust Co. v. Morrison*, 125 U. S. 591.

The rule governing in all these cases was stated by *Chief Justice Waite* in *Burnham v. Bowen*, 111 U. S. 776, 783, as follows: 'That if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use.' There has been no departure from this rule in any of the cases cited; it has been adhered to and reaffirmed in them all.'

In

Wood v. Guarantee Trust & Safe Deposit Co., 128 U. S. 416 (1888),

the Supreme Court refused to extend the principle of priorities to cases other than those which concerned public service corporations; and in

Thompson v. White Water Valley R. R. Co., 132 U. S. 68 (1889),

and in

Toledo etc. R. R. Co. v. Hamilton, 134 U. S. 296 (1890),

the court refused priority to construction claims.

The two cases of

Kneeland v. American Loan and Trust Co., 136 U. S. 89 (1890),

and

Kneeland v. Bass Foundry & Machine Wks., 140 U. S. 592 (1891),

are authorities for the general proposition that necessary expenses of a receivership will be made a charge upon the property itself, independently of income or the diversion of income. We shall later have occasion to further discuss these decisions.

In

*Morgan's Louisiana and Texas R. R. Co. v. Texas
Central Ry. Co.*, 137 U. S. 171 (1890),

a claim for priority which was based upon money loaned was denied upon the ground that, no matter to what use the money was devoted, the claim itself lacked the essentials which would entitle it to preferred payment. The case, which was decided by Chief Justice Fuller, repeats the rule of *Fosdick v. Schall* and states that a diversion of current income is necessary for the displacement of the mortgagee's lien, with the possible exception that, under circumstances such as those which were made to appear in the Miltenberger case, where the pursuit of any course other than the payment of prior claims might lead to cessation of operation, such payment might be warranted out of income, and would, if necessary, be made a charge on corpus.

In

*Virginia and Alabama Coal Co. v. Central R. R.
and Banking Co.*, 170 U. S. 355 (1898),

the litigation was initiated by a stockholder who sought to obtain the cancellation of a lease of the property of the defendant, a temporary receiver being appointed in March, 1892. The lessees appeared and disclaimed any rights under the lease, and, later in the same month, the preliminary receivers and others were appointed a board of receivers to take charge of the railroad pending the reorganization. As ancillary to the stockholder's bill the defendant railroad in 1892 filed a bill against the trustee and other creditors averring its insolvency, default in the payment of interest, and requesting the

court to call upon its creditors to come into court, and that the court administer the property for the benefit of all interested. The trustee assented to the continuance of the receivership. In January, 1893, the trustee filed its bill for foreclosure of the mortgage and the receivership was extended to that bill. The Alabama Coal Company filed an intervening petition based on engine coal furnished to the Danville Company while operating the Central Company's railroad, pursuant to contract. Recovery was sought out of the income of the receivership. The Circuit Court allowed recovery for coal used after the receiver was appointed, payable out of current earnings of the receivership. The Circuit Court of Appeals allowed priority also out of the income for the coal used during the receivership and the coal used prior to the receivership. It was stipulated that, under the receivership, a sum greater than intervenor's claim had been expended from income for the permanent improvement of the railroad. In considering the problem, thus raised, the court said (p. 365):

“It is immaterial in such case, in determining the right to be compensated out of the *surplus earnings of the receivership*, whether or not during the operation of the railroad by the company there had been a diversion of income for the benefit of the mortgage bondholders, either in payment of interest on mortgage bonds or expenditures for permanent improvements upon the property. Nor is the equity of a current supply claimant in subsequent income arising from the operation of a railroad under the direction of the court affected by the fact that while the company is operating its road its income is misappropriated and diverted to purposes which do not inure to the benefit of the mortgage bondholders and are foreign to the beneficial maintenance, pres-

ervation, and improvement of the property. This principle finds support in *Miltenberger v. Logansport, C. & S. W. Railway Company*, 106 U. S. 286, 311, 312, the decision in which case was approvingly referred to in *Union Trust Co. v. Illinois Midland R. Company*, 117 U. S. 434, and in the recent case of *Thomas v. Western Car Company*, 149 U. S. 95, 110."

The court considered it unnecessary to determine whether there had been diversion of income either before the receivership or during the receivership, since the equity of the intervenor extended to any surplus income of the receivership and there was such a surplus. It is, of course, apparent that the Supreme Court was here repeating its, by this time, familiar doctrine that surplus income which had been earned during the receivership might be used to pay creditors of the receivership or of a limited period prior thereto.

In

Southern Railway Co. v. Carnegie Steel Co., 176
U. S. 257 (1900),

the question presented was whether or not a company which furnished, prior to the appointment of a receiver, steel rails which were necessary for the operation of the railroad should be paid ahead of the trustee under the deed of trust out of the income from the property which accrued during the receivership. The court determined that the claim was entitled to preference out of earnings, investigated the facts as to what had been done with the earnings of the property that originally came into the hands of the receiver, as well as the earnings of the receivership, stated that large sums had been expended in the payment of interest, sinking fund and car trust

debts, and for construction and equipment, and that a clear case of diversion was shown. The conclusion reached by the court, speaking through Mr. Justice Harlan, is thus expressed (pp. 296-297):

“ * * * our conclusion is that, as current earnings which should have been applied in meeting current expenses or liabilities, including the debt due the Carnegie Company, were diverted for the benefit of the mortgage creditors, it was the duty of the court to see that that company was reinstated in its claim of priority over the mortgage creditors in the distribution or application of the net earnings of the company.”

It will thus be seen that the recovery is based upon diverted income, and that it is held that a claim, to be allowed, must be such as would ordinarily be met out of such income, and that priority is only allowed to the extent of the diversion.

In

Lackawanna Iron and Coal Co. v. Farmers Loan & Trust Co., 176 U. S. 298 (1900),

which concerned an alleged priority on account of steel rails purchased by the railroad company, such rails being imperatively needed for the safe transportation of persons and property, the court affirmed the decision of the lower court in rejecting the priority asserted, saying (p. 315):

“But we are of opinion that such expenditures as those incurred in the making of the contracts with the Lackawanna Company were not such as are made in the ordinary course of the operations of a railroad, and cannot be deemed current debts within the rule that a railroad mortgagee when accepting his security impliedly agrees that the current debts

of a railroad company contracted in the ordinary course of its business, in order to keep it a going concern, shall be paid out of current receipts before he has any claim upon such income. *Southern R. Co. v. Carnegie Steel Co.*, 176 U. S. 257. They are rather to be regarded as extraordinary expenditures, outside of the ordinary course of business and incurred for purposes, not of repair, but of construction. This court has said that it is the exception, not the rule, that the priority of mortgage liens can be displaced. *Kneeland v. American Loan & T. Co.*, 136 U. S. 89; *Thomas v. Western Car Co.*, 149 U. S. 95."

This case, like the preceding, it will be observed, proceeds strictly on the income theory of priorities, and determines that the claim asserted was not, in its nature, for a current debt.

The last case to be considered by the Supreme Court, and the one which we consider the most important case on the subject of prereceivership debts, is

Gregg v. Metropolitan Trust Co., 197 U. S. 183, decided March 6, 1905, the opinion being written by Mr. Justice Holmes.

The case is of such extreme importance in considering the problem now under discussion that a thorough examination of it is warranted. The petitioner, in pursuance of a contract of December 1, 1896, delivered railroad ties to the value of \$4709.53 in May and June, 1897. A receiver was appointed in proceedings for the foreclosure of two railroad mortgages on June 1, 1897. The receiver found on hand a portion of the ties of the value of \$3200, and these ties were later used by him in the maintenance of the railroad. The petitioner's claim

was against the corpus of the fund in the receiver's hands, after sale, for these and other necessary supplies furnished within six months, amounting in all to \$6804. The petitioner waived a special claim against the receiver for the ties received after the receivership, but claimed a lien for \$3200 for the ties on hand, not returned to him after the receiver's appointment. It was admitted that the claim was for cross ties essential to the replacement of ties decayed in the current operation of the railroad, and was a necessary operating expense in keeping and using the railroad and preserving the property in a fit and safe condition as such. There was no income on hand and no diversion of income shown, and the question was squarely presented whether, under the circumstances, the supplies could be paid for out of the proceeds of sale. The petition was denied by the Circuit Court and by the Circuit Court of Appeals, and, certiorari being allowed, the decision of the Circuit Court of Appeals was affirmed by the Supreme Court. We quote as follows from the opinion of Mr. Justice Holmes (pp. 186-7):

“The case stands as one in which there has been no diversion of income by which the mortgagees have profited, or otherwise, and the main question is the general one, whether, in such a case, a claim for necessary supplies furnished within six months before the receiver was appointed should be charged on the corpus of the fund. There are no special circumstances affecting the claim as a whole, and if it is charged on the corpus it can be only by laying down a general rule that such claims for supplies are entitled to precedence over a lien expressly created by a mortgage recorded before the contracts for supplies were made. An impression that such

a general rule was to be deduced from the decisions of this court led to an evidently unwilling application of it in *New England R. Co. v. Carnegie Steel Co.*, 21 C. C. A., 219, 33 U. S. App. 491, 75 Fed. 54, 58, and perhaps in other cases. But we are of opinion, for reasons that need no further statement (*Kneeland v. American Loan & T. Co.*, 136 U. S. 89, 97, 34 L. Ed. 379, 383, 10 Sup. Ct. Rep. 950), that the general rule is the other way, and has been recognized as being the other way by this court.

“The case principally relied on for giving priority to the claim for supplies is *Miltenberger v. Logansport, C. & S. W. R. Co.*, 106 U. S. 286, 27 L. Ed. 117, 1 Sup. Ct. Rep. 140. But, while the payment of some pre-existing claims was sanctioned in that case, it was expressly stated that ‘the payment of such debts stands, prima facie, on a different basis from the payment of claims arising under the receivership.’ The ground of such allowance as was made was not merely that the supplies were necessary for the preservation of the road, but that the payment was necessary to the business of the road,—a very different proposition. In the later cases the wholly exceptional character of the allowance is observed and marked. *Kneeland v. American Loan & T. Co.*, 136 U. S. 89, 97, 98; *Thomas v. Western Car Co.*, 149 U. S. 95, 110, 111; *Virginia & A. Coal Co. v. Central R. & Bkg. Co.*, 170 U. S. 355, 370. In *Union Trust Co. v. Illinois Midland R. Co.*, 117 U. S. 434, 465, labor claims accruing within six months before the appointment of the receiver were allowed without special discussion, but the principles laid down in the *Miltenberger* case had been repeated in the judgment of the court, and the allowance was said to be in accordance with them. It would seem from *St. Louis, A. & T. H. R. Co. v. Cleveland, C. C. & I. R. Co.*, 125 U. S. 658, 673, 674, that in both those cases there was a diversion of earnings. But the payment of the employees of the road is more certain to be necessary in order to keep it running than the payment of any other class of previously incurred debts.

“Cases like *Union Trust Co. v. Souther*, 107 U. S. 591, where the order appointing the receiver authorized him to pay debts for labor or supplies furnished within six months out of income, stand on the special theory which has been developed with regard to income, and afford no authority for a charge on the body of the fund. *Fosdick v. Schall*, 99 U. S. 235; *Burnham v. Bowen*, 111 U. S. 776; *Morgan’s Louisiana & T. R. & S. S. Co. v. Texas C. R. Co.*, 137 U. S. 171; *Virginia & A. Coal Co. v. Central R. & Bkg. Co.*, 170 U. S. 355; *Southern R. Co. v. Carnegie Steel Co.*, 176 U. S. 257. It is agreed that the petitioner may have a claim against surplus earnings, if any, in the hands of the receiver, but that question is not before us here.”

Mr. Justice Holmes then proceeded to discuss the order appointing the receiver. He pointed out that this order gave him authority but did not direct him to make various payments, among others, payment of employees and other persons having claims for wages, services, materials and supplies, due and to become due, and authorized him to borrow money on receiver’s certificates for the purpose of paying equipment trust debts and pay rolls accrued within six months prior to his appointment. Justice Holmes determined that while the receiver was thereby authorized to pay these debts he was not required to do so. In this connection we quote as follows from the opinion (p. 189):

“* * * it is not necessary to answer this contention at length. The original order gave the petitioner no such rights as he asserts. It would have been a stretch of authority for the receiver, in his discretion, to apply the borrowed money to this debt. At least, he was not bound to do so. The petition on which the original order was made stated that the money was wanted to pay certain obligations, ‘or

such much thereof as may be necessary,' embodying the distinction which we have drawn from the cases. We already have intimated that the payment of railroad hands might stand on stronger grounds than the payment for past supplies; and, if the payment was wrong, it would not be righted by making another, less obviously within the scope of the decree."

Mr. Justice McKenna, in an opinion in which Mr. Justice Harlan and Mr. Justice White concurred, dissented from the majority opinion upon the ground that the supplies were necessary to keep the road a going concern, and that, since, by their use, the road was in fact kept going, the claim should be allowed. The reasons thus advanced form the basis of what is termed "the going concern theory" contended for by appellees.

It is submitted that, in this case, the rule regarding claims for labor and materials furnished prior to a receivership invoked by the mortgagee is definitely settled. In such cases there will be no allowance in the absence of diversion. To this general statement there is one exception, an exception which, finding its beginning in the case of *Miltenberger v. Logansport Ry. Co.*, supra, is that where the payment of certain prereceivership claims is necessary to the continued business of the road such payment may be made even out of the corpus of the property. Mr. Justice McKenna dissented from the rule, thus laid down, upon the ground that a distinction could not be logically made between supplies that were necessary for the preservation of the road and those that were necessary to the business of the road. The contention of Justice McKenna is unquestionably right,

but it is, with all deference, submitted that Justice Holmes made no such distinction. The distinction considered in the majority opinion was not between supplies which were necessary for the preservation of the road and those which were necessary to the business of the road, but is between supplies which were necessary (when priority will not be allowed in the absence of diversion), and *payment* which was necessary for the continued business of the road, as Mr. Justice Holmes says, "a very different proposition."

As the Master has aptly said (Report on Law, p. 77):

"The necessity of the supplies themselves is an immaterial factor. What the majority opinion emphasizes as the exception contained in the Miltenberger case is the *necessity of payment*."

This, the court says, will justify the receiver in paying the claim in order to keep the road under his charge an operative property. The one exception, therefore, noted by Justice Holmes to the rule that there can be no priority allowed in the absence of earnings or the diversion of earnings, arises out of the necessity of payment or, as Judge Phillips designates it, "the imperious necessity of the situation". The fact that the debt arose out of supplies which were necessary to keep the road a going concern does not justify an allowance of priority.

It is objected by appellees that, under a doctrine such as that here suggested, no claim for priorities would ever arise since, if paid, the claims would be at an end, and, if not paid, the passage of time and the continued running of the road would prove that the

necessity was nonexistent. The Master makes this forceful reply to that objection (Rep. on Law, p. 78) :

“The reply is that this is true. In the exceptional case supposed, the question would come up either on an examination of the receiver’s accounts to determine whether the payment should be allowed to him, or possibly where receiver’s certificates had been issued and given in payment of the claims under order of court. It is not likely that the order, thus made, on the court’s view of a then present necessity would be afterward reversed because events had proved that the court was wrong.”

From the decisions here examined, commencing with *Fosdick v. Schall*, which was decided in 1879, to the *Gregg* case, the opinion in which was delivered in 1905, we submit that an harmonious set of rules upon this subject has been announced; that the income of an operated railroad accruing both before and after the appointment of a receiver may be used to pay the debts of operation incurred within a limited period prior to the appointment of the receiver; that, if such income is diverted either prior to the appointment or during the receivership itself, the mortgagee may, at the instance of an unsecured creditor whose claim comes within the limited class constantly referred to in the cases, be forced to restore that which it has inequitably withdrawn; that, unless there has been such diversion to the benefit of the mortgagee, no such restoration can be demanded, and that the prior lien of the trustee cannot be postponed. To this rule the one exception previously discussed may be added, that if a necessity for paying certain debts is made to

appear, such necessity being founded upon the proposition that, without their payment, continued operation of the property will be jeopardized, the court may, for the payment of such debts, impose a lien upon the corpus prior to that of the trustee. This is the only exception to the general rule.

The Master concluded, from his examination of the decisions previously considered, that the rule for which we are contending was so definitely settled by them that he might properly omit a detailed discussion of the cases decided on circuit. The reasonable limits of this brief very obviously warrant us in following that precedent. We shall, however, briefly refer to the rule laid down in the different circuits and to the leading cases in each circuit.

FIRST CIRCUIT.

In

Wood v. New York & New England Ry. Co., 70
Fed. 741,

decided by the Circuit Court, and in

New England Ry. Co. v. Carnegie Steel Co., 75
Fed. 54,

decided by the Circuit Court of Appeals, it was determined upon the supposed authority of the *Miltenberger* case that a court of equity, when called upon to foreclose a mortgage upon railroad property, might properly give priority to claims of laborers and those who furnished supplies necessary to keep the road a going concern from day to day regardless of the diversion of current income.

In the *Gregg* case, Mr. Justice Holmes, referring to the rule that labor and supplies were in some instances asserted to be entitled to priority over the bonds, said (p. 187):

“An impression that such a general rule was to be deduced from the decisions of this court led to an evidently unwilling application of it in *N. E. R. Co. v. Carnegie Steel Co.*, 21 C. C. A. 219, 33 U. S. App. 491, 75 Fed. 54, 58, and perhaps in other cases. But we are of opinion for reasons that need no further statement (*Kneeland v. American Loan & T. Co.*, 136 U. S. 89, 97; 34 L. Ed. 379, 383; 10 Sup. Ct. Rep. 950) that the general rule is the other way, and has been recognized as being the other way by this court.”

The Circuit Court of Appeals for the first circuit having, after the decision in the *Gregg* case had been rendered, occasion to again consider the same question in

Whelan v. Enterprise Transportation Co., 175
Fed. 212, 213,

said:

“In considering the matter, this court need not look beyond the cases decided in the Supreme Court, as these have been numerous, and, as in *Gregg v. Metropolitan Trust Company*, 197 U. S. 183, 25 Sup. Ct. 415, 49 L. Ed. 717, the Supreme Court disapproved the decisions of several courts of appeals. Even the Court of Appeals for this Circuit was said by the Supreme Court to have made in *New England R. Co. v. Carnegie Steel Company*, 75 Fed. 54, 58, 21 C. C. A. 219, ‘an evidently unwilling application’ of an erroneous impression.”

It is apparent, therefore, that in the first circuit the rule for which we contend has been adopted as the correct principle.

SECOND CIRCUIT.

No decision on this subject squarely in point has been rendered in this circuit, but in the recent cases which have grown out of the receivership of the New York Street Railway System, in

Pennsylvania Steel Co. v. New York City Ry. Co.,
208 Fed. 168,

and

Pennsylvania Steel Co. v. New York City Ry. Co.,
190 Fed. 609,

the reports of the Master, confirmed by Judge Lacombe, adopt the interpretation of the Gregg case, which we have suggested is correct.

THIRD CIRCUIT.

We find but one case in this circuit upon the subject:

Lee v. Pennsylvania Traction Co., 105 Fed. 405,

the opinion in which was delivered by District Judge McPherson.

The case, of course, arose some years before the Gregg case was decided. It holds that diversion is not necessary for the allowance of priority against the corpus of mortgaged railroad property, refers to the opinion of Mr. Justice Lurton, then Circuit Judge, in the case of

International Trust Co. v. Townsend Brick Co.,
95 Fed. 850,

which we shall later consider, and determines that the rule there laid down is not that of the Supreme Court.

In so far, therefore, as there has been a determination in the third circuit, the principle which we believe the Gregg case announces, has not been sanctioned.

FOURTH CIRCUIT.

The following cases upon the subject here at issue have been decided in this circuit:

Finance Co. v. Charleston R. R. Co., 48 Fed. 188;
Bound v. South Carolina Railway Co., 50 Fed. 312;

Bound v. South Carolina Railway Co., 58 Fed. 473;

Street v. Maryland Central Railway Co., 59 Fed. 25;

Finance Company v. Charleston Railway Co., 62 Fed. 205;

Southern Railway Co. v. Carnegie Steel Co., 76 Fed. 492;

Southern Railway Co. v. Ensign Mfg. Co., 117 Fed. 417;

Southern Railway Co. v. Chapman-Jack Co., 117 Fed. 424;

Queen Anne's Ferry Co. v. Queen Anne's Ry. Co., 148 Fed. 41;

Bernard v. Union Trust Co., 159 Fed. 620.

IN

Finance Company v. Charleston Ry. Co., 48 Fed. 188, 190,

the opinion in which was written by Judge Simonton, the rule was laid down as follows:

“Necessarily this equity springs out of, depends entirely on, the diversion. Were it not for this diversion,—this taking of the money justly applicable to one class and using it for the benefit of another,—the equity could not exist. If there be no earnings, or if the earnings are insufficient to pay expenses, and there be no permanent improvements made, and no interest whatever paid, upon no principle of law or equity could the bondholder be made to pay out of his own property the debts of the common debtor. This would be not only a thorough disregard of the sanctity of a contract obligation, (*Kneeland v. Trust Co.*, 136 U. S. 97, 10 Sup. Ct. Rep. 950) it would be confiscation of property.”

From

Finance Company v. Charleston Ry. Co., 62 Fed.
205, 208,

decided by the Circuit Court of Appeals, we quote as follows from the opinion delivered by Mr. Chief Justice Fuller:

“It must be regarded as settled that a court of equity may make it a condition of the issue of an order for the appointment of a receiver of a railroad company that certain outstanding debts of the company shall be paid from the income that may be collected by the receiver, or from the proceeds of sale; that preferential payments may be directed of unpaid debts for operating expenses, accrued within 90 days, and of limited amounts due to other and connecting lines of road for materials and repairs and for unpaid ticket and freight balances, in view of the interests both of the property and of the public, that the property may be preserved and disposed of as a going concern, and the company’s public duties discharged; and that such indebtedness may be given priority, notwithstanding there may have been no diversion of in-

come, or that the order for payment was not made at the time, and as a condition, of the receiver's appointment, the necessity and propriety of making it depending upon the facts and circumstances of the particular case, and the character of the claims."

The rule thus laid down is stated to be based upon the decision of the *Miltenberger* case, is announced by the same judge who had previously delivered the opinion of the Supreme Court in *Morgan's Louisiana Line v. Texas Central R. R. Co.*, supra, and obviously has in mind the exception to the general rule by which it is provided that where payment of existing claims is necessary to preserve the property, such payment may be properly authorized by a court of equity.

In

Southern Railway Co. v. Ensign Mfg. Co., supra, the same rule is laid down, in the following language (p. 420):

"In this way those furnishing such necessary labor and supplies are assured that, even if the railroad should unexpectedly go into the hands of receivers, the earnings thereafter will be applied to meet their demands; and if, in the operation of a railroad by a receiver, earnings which should have been used in meeting obligations for current supplies are diverted from this purpose, and are used for the advantage of the mortgage creditors, such diversion must be made good, even if it be necessary to encroach upon the corpus of the mortgaged property."

We have quoted from the above cases for the reason that claimants in this case have asserted that the construction of the *Gregg* case which we have contended for is not one which has received the sanction of the

Court of Appeals in the fourth circuit. We submit that there is no rule announced in these cases which is inconsistent with the principles applied in the *Gregg* case.

FIFTH CIRCUIT.

The theory which requires proof of a diversion of income for the allowance of a priority, with the single exception above referred to, has been definitely adopted as the rule of this circuit in

Farmers Co. v. Vicksburg Ry. Co., 33 Fed. 778,

and by the Circuit Court of Appeals in

Clark v. Central R. R. Co., 66 Fed. 803.

SIXTH CIRCUIT.

In ten cases considered in this circuit, eight of which were decided by the Circuit Court of Appeals, the rule of the *Gregg* case, as contended for by us, has been followed. In six of the decisions by the Circuit Court of Appeals, the opinions were written by Mr. Justice Lurton.

The ten cases above referred to are:

Central Trust Co. v. East Tenn. R. Co., 80 Fed. 624;

Louisville & N. R. Co. v. Central Trust Co., 87 Fed. 500;

Ruhlender v. Chesapeake etc. Ry. Co., 91 Fed. 5 (C. C. A.);

Thomas v. Cincinnati etc. Ry. Co., 91 Fed. 195;

International Trust Co. v. Townsend Brick Co., 95 Fed. 850;

Contracting Co. v. Continental Trust Co., 108 Fed. 1;

Rhode Island Locomotive Works v. Continental Trust Co., 108 Fed. 5;

Gregg v. Mercantile Trust Co., 109 Fed. 220;

Monsarrat v. Mercantile Trust Co., 109 Fed. 230;

Gregg v. Metropolitan Trust Co., 124 Fed. 721.

Because of the admirable clearness with which the rule is stated, we quote as follows from the opinion of Mr. Justice Lurton, speaking for the Circuit Court of Appeals in

Gregg v. Mercantile Trust Co., 109 Fed. 220, 227:

“The ground upon which this doctrine of the primary appropriation of income to the payment of current operating expenses rests is that the mortgagee impliedly consents. This implication of consent arises from the fact that a railroad mortgage is a very peculiar kind of property. Looking to the long time of such mortgages, the fact that the mortgagor is expected to remain in possession until default, that the value of the property is largely dependent upon its continued operation, and that the preservation of the franchises of such companies depends upon their continual exercise, it is not an unreasonable assumption that ‘every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income’. *Fosdick v. Schall*, *supra*. The displacement of mortgage liens cannot be justified upon any line of reasoning which assumes that one class of creditors may be deprived of the benefits of their contract liens for the benefit of another upon the ground that the public interests are thereby subserved by the maintenance of a railway for the public convenience. Such a position antagonizes

the constitutional principle that private property shall not be taken for the public benefit without compensation. The public character of such companies is only considered as one of the factors in arriving at the conclusion that the mortgagee of the income contracts only in respect to net income. But, if income alone is applicable to the payment of such operating expenses, how has it come about that in many instances such creditors have been paid out of the corpus of mortgaged property? The ground upon which a mortgage upon the corpus may be displaced is most logically stated by Chief Justice Waite in *Fosdick v. Schall*."

SEVENTH CIRCUIT.

In the seventh circuit the question has been only once squarely presented, but the rule subsequently stated in the *Gregg* case was therein applied.

Calhoun v. Railway Co., 14 Fed. 9.

In later cases on the question of alleged priorities, the claims have in each case been denied on grounds other than those here considered.

Thomas v. Peoria Ry. Co., 36 Fed. 808;

Farmers L. & T. Co. v. Green Bay Ry. Co., 45 Fed. 664;

Mather Humane Stock Transportation Co. v. Anderson, 76 Fed. 164.

EIGHTH CIRCUIT.

In this circuit, as in the first, the early decisions, most of which were rendered by Judge Caldwell, followed the interpretation of the *Carnegie Steel Company* case, which was termed by Mr. Justice Holmes

in the *Gregg* case “an unwilling application of an erroneous impression.”

It was, for instance, held in

Farmers L. & T. Co. v. Kas. City Ry. Co., 53
Fed. 182,

that allowance might be made regardless of a diversion, but in the later cases—notably

Illinois Trust & Savings Bank v. Doud, 105
Fed. 123;

Fordyce v. Omaha Ry. Co., 145 Fed. 544, and
Rodger Ballast Car Co. v. Omaha Ry. Co., 154
Fed. 629,

the first and last of which were decided by the Circuit Court of Appeals for the Eighth Circuit, it was determined that a diversion was essential for the allowance of priorities.

We quote as follows from the opinion of Judge Sanborn, in

Illinois Trust Co. v. Doud, *supra*;

“A mortgagee of the property, acquired and to be acquired, and of the income of a quasi public corporation, such as a railroad company, obtains a lien upon the net income of the company after the current expenses of operation incurred in the ordinary course of business are paid, and impliedly agrees that the gross income shall be first applied to the payment of these current expenses, before the net income to which he is entitled arises. A court of equity engaged in administering mortgaged railroad property under a receivership in a foreclosure suit may prefer unpaid claims for current expenses of the ordinary operation of the railroad, incurred within a limited time before the receivership, to a prior mortgage lien, in the

distribution of the income or of the proceeds of the mortgaged property. If such a mortgagor diverts the current income from the payment of current expenses to the payment of interest on the mortgage debt, or to the improvement of the mortgaged property, so that the current expenses remain unpaid when a receiver is appointed, the court may, out of the income accruing during the receivership, restore to the unpaid claims for current expenses the amount so diverted. But if there has been no diversion there can be no restoration, and the amount of the restoration cannot exceed the amount of the diversion."

The other cases in this circuit which bear on the question are:

- Dow v. Memphis R. Co.*, 20 Fed. 260;
Blair v. St. Louis R. Co., 22 Fed. 471;
Blair v. St. Louis R. Co., 25 Fed. 232;
Central Trust Co. v. St. Louis R. Co., 41 Fed. 551;
Northern Pac. R. Co. v. Lamont, 69 Fed. 23;
Trust Co. v. Riley, 70 Fed. 32;
Pullman Palace Car Co. v. American L. & T. Co., 84 Fed. 18;
Veatch v. Am. L. & T. Co., 84 Fed. 274;
Illinois Trust etc. Bank v. Ottumwa Ry., 89 Fed. 235;
Manhattan Trust Co. v. Sioux City R. Co., 102 Fed. 710;
Kansas Loan & T. Co. v. Electric Ry. etc. Co., 108 Fed. 702;
Atlantic Trust Co. v. Dana, 128 Fed. 209;
State Trust Co. v. Kansas City etc. R. Co., 129 Fed. 455;
Fordyce v. Omaha Ry. Co., 145 Fed. 544.

NINTH CIRCUIT.

In this circuit it has been held that the claims of laborers and those who furnished supplies in the current operation of a railroad during the six months' period preceding the appointment of a receiver are entitled to payment out of the property before the mortgage debt is paid, irrespective of the diversion of current income. There are three such decisions.

In a Circuit Court case,

Atlantic Trust Co. v. Woodbridge Canal and I. Co., 79 Fed. 39, 41,

Mr. Justice McKenna, at that time circuit judge, in determining the rights of labor claims to displace the lien of a previously vested mortgage, said:

“ * * * it is clear that diversion of income is not a universal condition of preference”,

and allowed such claimants a prior lien upon the property without any showing as to diversion.

In

New York Guaranty Co. v. Tacoma Ry. Co., 83 Fed. 365,

this court made a like ruling. The opinion was written by Judge Morrow. The claim asserted was for wire cable necessary to keep the street railway a going concern, and furnished during the six months' period prior to the appointment of the receiver. The court determined that the claim came within the class of those entitled to priority and directed that it be paid ahead of the bonds which were secured by a previously vested mortgage, irrespective of the fact that there had been no diversion of income.

The third case was again a Circuit Court decision, that of

Atlantic Trust Co. v. Woodbridge Canal Co.,
86 Fed. 975.

The opinion was by Judge Morrow. Labor claims were involved, and it was admitted that the services for which claims were made were necessary to keep the system a going concern. No diversion was shown to have occurred, there was no showing that payment was necessary to preserve the property, but the claims were, nevertheless, awarded priority over a mortgage previously given to secure bonds.

The case last discussed referred to no authority in support of the rule applied. The decision in the earlier *Woodbridge Canal Company* case relied, for authority, on

Farmers Loan and Trust Co. v. Kansas City Ry. Co., 53 Fed. 182;
Riley v. Trust Co., 70 Fed. 32;
Finance Co. v. Charleston Ry. Co., 52 Fed. 678;
Wood v. New England Ry. Co., 70 Fed. 741.

In the Tacoma case the court, after discussing numerous decisions of the Supreme Court on the subject as to what character of debts may be allowed priority, rested its conclusion that diversion was not essential to the allowance of priority upon

Farmers Loan and Trust Co. v. Kansas City Ry. Co., supra;
Atlantic Trust Co. v. Woodbridge Canal Co., supra;

Finance Co. v. Charleston Ry. Co., supra;
Wood v. New England Ry. Co., supra.

The first of the cases thus cited,

Farmers Loan and Trust Co. v. Kansas City Ry. Co.,

did, it is true, hold that claimants may displace a mortgage lien even though there is no showing that income has been diverted, but, as we have already pointed out in our discussion of the present rule of the eighth circuit, that decision has been overruled by the Circuit Court of Appeals of that circuit, and the application of the principles of the *Gregg* case conceded.

The next case referred to,

Riley v. Trust Company,

states, in language almost identical to that previously used by us, the rule for which we contend, it being there said:

“There are certain claims against a mortgaged railroad company, accruing before the appointment of a receiver, which are entitled to a preference over a prior mortgage debt in payment out of the earnings of the railroad during the receivership and out of the proceeds of the sale of its property. * * * Claims of this character have been given a preference over the mortgage debt by these decisions on one of two grounds,—either on the ground that the mortgage is a lien on the net, and not on the gross, income of the railway company, and where that part of the income that is applicable to the payment of current expenses of operation, proper equipment, and necessary improvements has been diverted to pay interest on the mortgage debt or to otherwise benefit the security, and this diversion has left claims for

these expenses unpaid, it is the province and duty of the chancellor to restore the diverted fund by taking an equal amount from the earnings of the railway company during the receivership, and applying it to the payment of these claims in preference to the mortgage debt; * * * or on the ground that *the payment* of the claims is necessary to preserve the mortgaged railroad and to keep it a going concern.”

The third case cited,

Finance Company v. Charleston Ry. Co.,

has already been discussed by us while considering the decisions of the fourth circuit, and states, as we have shown, that a diversion is essential unless, because of imperious necessity, the payment of certain claims is required.

The last case cited,

Wood v. New England Ry. Co.,

was, when the decisions in this circuit were rendered, authority for the result there reached, but that decision was disapproved by Mr. Justice Holmes in the Gregg case, and the Court of Appeals for the first circuit has, it will be recalled, itself referred to the fact that its decision in the case was overruled, and admitted that it did not correctly interpret the rule of the Supreme Court which was laid down in the *Miltenberger* case.

It is worthy of note that no one of the cases cited, and no one of the cases in this circuit, was decided after the opinion in the Gregg case was delivered.

Notwithstanding the plain statement of the rule previously announced in this circuit, the Master was per-

sueded that the decisions referred to were overruled by the *Gregg* case. Judge Van Fleet, however, relying entirely on those decisions, reversed the Master's ruling, saying, with reference to the opinion of Mr. Justice Holmes:

"I have given that case very careful consideration, and while the reasoning of the Court is such as to lend considerable weight to the views of the Master as deduced therefrom, I am nevertheless not satisfied that the case so clearly contravenes the doctrine that has been established in this circuit that I would be at liberty to assume that it necessarily overrules it."

The *Gregg* case we have already considered. We have shown that it involved supplies necessary to the business of the railroad in question, and that, there being no diversion, allowance was denied. The rule of that case is directly applicable to those claimants whose names appear on Exhibit "B" and who furnished supplies to Ocean Shore Railway Company during the six months' period. Nor is there any distinction which can logically be made between labor claimants and supply claimants.

Union Trust Co. v. Illinois Midland Ry. Co.,
supra;

Master's Report, 38;

Master's Report on the Law, 81;

Opinion of District Court, Rec. 104.

It is respectfully submitted that the rule followed in this circuit is not the true rule, that it has been expressly disapproved by the Supreme Court in the *Gregg* case, that it now has the sanction of no one

of the other eight courts of appeal, and that it should not be applied in this case.

THE APPLICATION OF THE RULE TO THE FACTS OF THIS CASE.

The record in our case clearly shows that there was no diversion during the receivership, that \$30,000 was diverted prior to the appointment of the receiver, and that there was no order made for the payment of any claims other than those whose names appear in Exhibit "C". Upon these points the court and the Master agreed.

It needs no argument, therefore, to support the proposition that, if the rule of the *Gregg* case is to be followed, the maximum amounts to which claimants whose names appear in Exhibits "A" and "B" (Rec. pp. 41-51) are entitled are those appearing in column 3 of those exhibits, opposite the name of each claimant (the total of such amounts being \$30,000), and that the District Court erred in awarding a judgment in favor of those claimants for the amounts set forth in column 4 thereof (the total of such amounts being \$48,571.42).

NO CLAIMANT CAN PROFIT BY A DIVERSION UNLESS HE SHOWS THAT A DIVERSION OCCURRED AFTER HIS INDEBTEDNESS BECAME PAYABLE.

Assuming, then, that a claimant may only share in the proceeds of sale when he comes within the "limited class" so often referred to, and when there has

been a diversion of income to the benefit of the mortgagor, or when, because of imperious necessity, his claim has been ordered paid, we are next called upon to consider when a diversion must occur, with relation to the time at which any given claim becomes payable, for such diversion to warrant the displacement of the lien of a previously vested mortgage.

The principle upon which it is held that proof of the diversion of current income from operation aids general unsecured creditors is that, at the time such creditors' debts should have been paid, funds arising out of income and available for that purpose were improperly devoted to the payment of other expenses. It follows logically from this that there can be no diversion as to any given individual until his debt has become due. The company is, of course, not bound to keep any fund on hand to pay indebtedness which may in the future arise. The principle of diversion only requires that current debts of operation shall be paid, as they mature, out of current earnings.

That this is the correct rule, the cases plainly show.

We quote from the opinion of Mr. Justice Matthews in

St. Louis R. R. Co. v. Cleveland Railway Co.,
125 U. S. 658; 31 L. Ed. 837,

as follows (p. 675):

“From the beginning of operations under the lease in 1867 until April 1, 1878, the Indianapolis and St. Louis Railroad Company paid in full, as it accrued, the whole amount of the rental called for by the lease. During that period, the lessee,

being in no default at any time on account of rent, had a legal right to appropriate any surplus of its gross earnings to the payment of interest on bonds, or for the improvement and additional equipment of its road. It was not bound to accumulate, out of the surplus of gross earnings, prior to 1878, a fund to meet possible contingencies in respect to rent that might arise after that date. The petitioner, therefore, has no right to complain of any appropriation of the earnings of the leased line during the period in which it received the full amount due to it."

From the opinion of Judge Lurton, in

Central Trust Co. v. E. Tennessee R. R. Co., 80
Fed. 624,

we quote as follows:

"Prior to the period covered by the maturity of appellants' claims, there was a surplus of gross earnings over all operating expenses; but it cannot be contended that the company was under any obligation to future creditors to accumulate a surplus to meet possible deficiencies in the income to meet future income debts, or that it was improper to apply such surplus in payment of interest."

Judge Phillips is quoted as saying in

Kansas L. & T. Co. v. Electric Co., 108 Fed. 702,
703.

"The first objection to this statement is that the master has taken a period ranging from May 1, 1898, to February, 1900, covering a period of nearly two years anterior to the appointment of the receivers, and beginning a year and a half nearly before the intervener's account against the defendant companies was created. This intervener has nothing to do with the earnings of the road,

or their diversion by the road, prior to the creation of its debt. The creditor can only concern himself about diversions of the current earnings after the creation of his debt. It devolves upon the intervener to show what sums were diverted after the creation of his claim, and he must show by his evidence into what the diverted sum went, so that the court can determine whether it was an improvement or betterment which inured to the benefit of the mortgagee. If the master is unable to ascertain from the evidence presented by the intervener how much was diverted, and into what particular property the diversion went, the intervener's claim must fail for want of proof."

From the most recent decision on the subject,

Fordyce v. Omaha Railroad Co., 145 Fed. 544,
555,

we quote as follows:

"(2) In some of the claims counsel for interveners have attempted to show diversions prior to the creation of the debts sought to be enforced as an equitable lien. This court in *Kansas Loan & Trust Co. v. Electric Railway, etc., Co.*, 108 Fed. 703, said:

" 'This intervener has nothing to do with the earnings of the road or their diversion by the road prior to the creation of its debt. The creditor can only concern himself about diversions of the current earnings after the creation of his debt.'

"In *Central Trust Co. v. East Tennessee Ry. Co.*, 80 Fed. 624, 626, 26 C. C. A. 30, Judge Lurton said:

" 'Prior to the period covered by the maturity of appellants' claims, there was a surplus of gross earnings over all operating expenses; but it cannot be contended that the company was under any obligation to future creditors to accumulate a sur-

plus to meet possible deficiencies in the income to meet future income debts, or that it was improper to apply such surplus in payment of interest.' ”

In the Agreed Statement of Facts (p. 30) we find the following stipulation:

“There was no evidence introduced as to the time at which said diversion, or any part thereof, occurred, except that the same occurred between June 1, 1909, and December 6, 1909, nor was any evidence introduced to show that such diversion took place after any of the claims referred to in Exhibits ‘A’ and ‘B’ accrued or became payable.”

The admission that there is no showing that Ocean Shore Railway Company diverted any of its earnings during the six months’ period after any claimant had performed services or furnished materials to that company makes no conclusion possible other than the one that no claimant has met the burden of proof which the law casts upon him. The point here made was insisted upon both before the Master and District Court (Rec. pp. 31-33). It was neither referred to nor discussed by the District Court. The Master, considering this question at pages 36, 37 and 38 of his report, referred to the cases above cited, quoted from the language of two of them, and then proceeded as follows:

“In each of these cases it is to be pointed out the matter came up on a single intervention, where, it would seem, the principle could properly be applied. In each of them, also, the claimant attempted to go back into a prior period to the ‘current period,’ whether six months or longer as to the court might seem proper, and establish a diversion during the prior period. The cases would be entirely in point if in the case at bar no diver-

sion were proved during the period taken as the current period, namely, the six months interval before the receivership, and the claimant offered proof of a diversion of funds occurring in the year 1908. No case has been cited where the test contended for was applied with regard to diversion during the period within which preferences are recognized. It must, of course, be acknowledged that some of the language of the cases cited would apply to the end contended for, but here, as generally, the court must be understood as speaking with reference to the facts of the case then at bar.

“I am unable to accept any such limitation. It is obvious that the rule contended for is impossible of application in any proceeding where there are a number of claims. A balance would have to be struck at the end of each day during the six months period, settling claims due on that day and diversions occurring thereafter, and taking into account restoration of diversion by borrowed money, etc. It is safe to say that such an inquiry would be impossible, and the law adopts no rule which cannot be applied by the use of the ordinary human faculties.”

It will be seen that the Master assigns three reasons for his failure to apply the rule sanctioned by both the Supreme Court and various Federal decisions. Those reasons are, first, that in each of the cases cited a single intervention was considered; second, that no case has been referred to where the test contended for was applied with regard to diversion during which preferences were recognized; and, third, that the rule suggested cannot be applied where there are numerous claims, as was the case in the present reference.

The first and third objections are substantially the same and may be considered together. They may

fairly be stated thus: The rule applied in the cases cited is a correct legal principle and may be invoked by a mortgagee when a single claimant is asserting his right to priority and the claim defeated unless the diversion is shown to have occurred after the debt became payable; but, where a large number of claims are asserted in one reference, the rule will not be applied because of the labor involved in determining the time of diversion as regards each claim. It is apparent that, if the contention of the Master is correct, it deprives a mortgagee who has two opponents in one proceeding of a protection which he might invoke if he were contesting the claims of each separately. This is obviously an untenable proposition. Nor are we able to appreciate upon what terms the statement that "such an inquiry would be impossible" is based. There are, in our case, fifty-four supply claimants and a large number of labor claimants. On the intervention of any *one* claimant, the Master, by implication, concedes that he would have required proof that a diversion occurred after the supplies or labor were furnished. Does the ascertainment of the same fact as to the other fifty-three involve anything more than an additional investigation? We are unable to see a situation here in which the principle that the law does not require impossibilities may properly be invoked.

The second objection to the application of the rule ignores the fundamental principle upon which the doctrine of diversion rests. If it is a fact, as stated by Mr. Justice Matthews in the Supreme Court case, that a petitioner has no cause for complaint, on account of the

diversion of current income, until payment on account of his claim is due to him, is not the test of time necessarily to be applied to the time that the debt itself was incurred? Let us assume, as we are entitled to do from the record, that some of the claims with which we are concerned became payable in June, and that the diversion occurred in December. Is a judgment which ignores the fact that there was no diversion until six months after the claims arose consistent with the rule of the cases cited? In response to the suggestion that, in each of those cases, the claimant attempted to go back into a period prior to the "current period", we respond that, as to the decision of the Supreme Court, this is true, but we think that the Master is in error as to two of the Federal cases referred to. There is no showing, which we are able to find, that that was so in the *Central Trust Company* case, decided by Judge Lurton, or in the *Fordyce* case, decided by Judge Phillips, and such is certainly not to be inferred from the language used in those opinions. In all the cases claimants, of course, attempted to go back into a period prior to that in which the supplies were furnished by them, but unless they had done that it is apparent that the rule discussed could never have been invoked. The only question to be determined is when the diversion is shown to have occurred with relation to the maturity of the claim.

It is submitted that, for this reason, no claimant is entitled to profit by the diversion shown, or to priority against the property purchased at the sale of January 17, 1911.

II.

THE FIRST LIEN OF A RAILROAD MORTGAGEE CANNOT BE SUBORDINATED TO THE EQUITABLE LIEN OF UNSECURED CREDITORS UNLESS IT INITIATES THE FORECLOSURE PROCEEDINGS AND SECURES THE APPOINTMENT OF A RECEIVER.

It will be recalled that, in our examination of the cases dealing with the diversion of current income, we reserved for future discussion the question as to what application the principle that "he who seeks equity must do equity" has to this case. We now turn to a consideration of that question.

On December 1, 1909, the following situation existed: There was outstanding and of record a deed of trust, executed on November 1, 1905, covering all property of Ocean Shore Railway Company, including that which it might subsequently acquire, as well as that which it owned in 1905. There were unpaid, unsecured creditors of the company, among whom were those whose names appear in the exhibits annexed to the Agreed Statement of Facts (Record, pp. 41-51). Had any one of these creditors at that time commenced an action, either at law or in equity, to enforce the payment of his claim and to subject to the payment of such claim any of the property covered by the trust deed, it needs no argument to demonstrate that such a suit could not have been maintained. Income from operation, if any there was, might have been resorted to, but, by pleading the existence of the mortgage, the trustee would have prevented any displacement of its lien upon corpus. When, however, one of these same creditors commenced

an action in a court of equity, in which a receiver of the properties of the company was appointed, it is asserted by the appellees, and has been determined by the lower court, that, through the institution of such proceeding, the previously existing first lien of the trustee was displaced and, in its stead, a lien in favor of general creditors arose. Upon what principle of law is such a result based? What were the considerations which warranted the chancellor in taking from the bondholders the security upon which they relied for the payment of their bonds and applying the proceeds of that security to the payment of the claims of those who, with a full knowledge of the bondholders' rights, dealt directly with the company itself? Does not any rule which produces this result "impair the sacredness of contract obligations"?

If, at the instance of an unsecured creditor, a court of equity assumes the control of the properties of a railway company, thus depriving the mortgagee of a remedy expressly given to it by the terms of the trust deed,—the summary right of sale—why should a mortgagee lose not only the direct means of protecting himself, upon which he has relied, but also subject to loss and destruction, by such an act over which he has no control and which he has not initiated, the very security which he most wishes to preserve? It is submitted that he is not thus prejudiced. Conceding that those who furnish to a railroad in its operation from day to day labor or supplies are entitled to be paid out of the income from operation before such income shall be subjected to the lien of the trust deed, we submit that

in no instance where the mortgagee is not the moving party in obtaining the appointment can expenses incurred before the court assumes control be made a lien upon the property prior to that of a previously executed and recorded deed of trust unless the continued operation of the properties requires it. In that case the payment is virtually a necessary expense of the receivership and is not, in any sense, based upon the principle that claimants are entitled to displace a mortgage lien. The reason that such priority will be denied, in a case in which some one other than the mortgagee is a complainant, is neither complicated nor involved. It is simply that the mortgagee has done nothing to prejudice vested and existing rights. When a mortgagee seeks to foreclose a mortgage he comes into equity and asks its aid. He may then be made to do equity in return. The doing of equity may consist in subordinating for certain purposes and to certain limits, the priority of his lien. By the course which he has chosen to pursue and because of the equitable aid he has obtained, he may be required to make concessions. The concession thus required may take the form of a grant of priority to unsecured claimants, such priority being allowed in accordance with well settled rules, the primary one resting upon the doctrine of diversion. If however, the mortgagee asks no favors, he need grant none, and no act of creditors can postpone his lien upon the corpus of the property itself.

The argument we make is, therefore, this: A mortgagee claiming under a valid deed of trust has an absolute and unassailable right to resort to the corpus of

the trust fund to satisfy the bonded indebtedness. If he is content to rely upon his legal rights, those rights will not be taken from him. Unless he applies to a court of equity for protection and help he cannot be forced by that court to concede the protection which he has, by his own forethought, secured.

It should be further observed that diversion of current income by the mortgagor has no effect upon the correctness of the rule. The very statement of the contention, that an act of the mortgagor may prejudice a previously vested right of the mortgagee, carries on its face its invalidity. The rule suggested would, if applied, obviously result in an impairment of the obligation of the trustee's contract and would deprive him of his rights under it. He is in no way bound to see that income is, in fact, applied to the payment of creditors. He is alone concerned with the fact that his lien on income does not attach until such debts have been paid.

We, therefore, submit that the lien of the trustee will be postponed in favor of creditors whose claims accrued before the receiver was appointed only where the mortgagee is the moving party in the receivership proceedings. The theory, thus advanced, as to the allowance of priorities is stated in the reports too often and too plainly, it seems to us, to leave room for doubt as to the principle upon which such preferred payments may be made. Announced in what we have previously called the "leading case on the subject", *Fosdick v. Schall*, 99 U. S. 235, and repeatedly affirmed in de-

cisions of the Supreme Court of the United States, the principle is thus stated by Mr. Justice Waite:

“we have no doubt that when a court of chancery is asked by railroad mortgagees to appoint a receiver of railroad property pending proceedings for foreclosure, the court, in the exercise of its sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms in reference to the payment from the income during receivership of outstanding debts for labor, supplies, equipment or permanent improvement of the mortgaged property as may, under the circumstances of the particular case, appear to be reasonable. Railroad mortgages and the rights of railroad mortgagees are comparatively new in the history of judicial proceedings. They are peculiar in their character and affect peculiar interests. * * * The mortgagee has his strict rights which he may enforce in the ordinary way. If he asks no favors, he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such an application always calls for the exercise of judicial discretion; and the chancellor should so mold his order that, while favoring one, injustice is not done to another. If this cannot be accomplished, the application should ordinarily be denied.”

In

Kneeland v. American Loan and Trust Co., 136

U. S. 89, 97,

a controversy between a purchaser at foreclosure sale of railroad property and intervening creditors who asked payment out of the proceeds of sale on ac-

count of car rentals was before the court. The claims in question arose during the receivership and were not based upon services rendered prior to the appointment; and, for that reason are not directly in point on this appeal. The claims, however, were denied priority upon the ground, among others, that they were incurred when the mortgagee was not the moving party in the receivership proceedings and hence could not be made to forego the rights which had become vested through the execution and recording of the mortgage. For this reason the case seems to us even stronger than it would have been had prereceivership debts been under consideration. If an indebtedness of the receivership itself may not be paid out of the trust property because the proceeding was not instituted by the mortgagee, with how much greater force may the same argument be applied to claims which accrued before the possession of the property was assumed by the court. We quote as follows from the opinion of Mr. Justice Brewer:

“The receivership was at the instance of a judgment creditor, and was with a view of reaching the surplus earnings for the satisfaction of his debt. It was not at the instance of mortgagees, nor were they seeking foreclosure of their mortgages. They were asking nothing at the hands of the court. They were not asking it to take charge of the property, *or thus impliedly consenting to its management of the property for their benefit.* * * *

A court which appoints a receiver acquires, by virtue of that appointment, certain rights and assumes certain obligations, and the expenses which the court creates in discharge of those obligations are burdens necessarily on the property taken pos-

session of, and this irrespective of the question who may be the ultimate owner, or who may have the preferred lien, or who may invoke the receivership. * * * The court never made any order for the rental of this rolling stock, and the situation of all the parties during this four months' receivership was this: The railroad company, with its franchises for building and operating a railroad, was in equity, whatever may have been the location of the legal title, the owner of realty, subject to certain fixed mortgage indebtedness, and of personalty, the rolling stock in question, subject to certain fixed liens. The creation, in the first instance, of those liens gave to neither lien holder, against the other, priority in payment otherwise than in respect to the property specially charged with those liens. The holder of the lien on the real estate could not insist that both the real estate and the personalty should be subjected to the payment of his debt, before payment to the holder of the lien on the personalty of his claim, out of the proceeds of its sale. Neither, on the other hand, could the holder of the lien on the personalty insist that his lien should be first paid out of any proceeds of the realty. Each was limited to his priority of right on the property on which his lien rested. Under those circumstances, neither the holder of the lien on the real or the personal property moving in the premises, a general creditor of the common debtor invoked for the payment of his debt the intervention of a court of equity and the possession of all the property charged with these two liens, and its operation with a view to the collection of his unsecured claim. The operation of the road during that receivership did not pay the operating expenses. May the holder of a lien on the real estate insist that the deficiency be charged to the holder of the lien on the personalty, or that the latter shall become liable to the former for the rental of its property? Unquestionably not. *Neither lien-*

holder asking the aid of the court, no obligation was assumed by either in respect to the management of the property as against the other."

The Supreme Court in *Virginia etc. Coal Company v. Central Railroad Company*, supra, in referring to the Kneeland case, said:

"Particular attention was called, among other things, to the fact that the receivership at the suit of the judgment creditor was not for the benefit of the mortgage bond holders, so that it could not be asserted that the expenditures of such receivership were payable in any event out of the income or corpus of the property."

There are numerous decisions of the Federal Court in which the same rule is either applied or referred to:

Finance Co. v. Charleston Ry. Co., 49 Fed. 693;

Clyde v. Richmond, 56 Fed. 539;

St. Louis Ry. Co. v. Hollbrook, 73 Fed. 112;

New England R. R. v. Carnegie Steel Co., 75 Fed. 54;

Atlantic Trust Co. v. Dana, 128 Fed. 209.

One of the Federal decisions, however, rendered by Judge Simonton, is so squarely in point and so clearly states the principle that the allowance of priorities is based upon the equitable principle that "he who seeks equity must do equity" that we quote from it as follows:

"This is an equity founded upon the doctrine that the officers of a railway company are trustees, or, perhaps, we should say the recipients and holders, of a trust fund, applicable first to claims of this character, and after them to the interest on the mortgage debt. The origin and reason for this

equity are found in the fact that a going railroad is of public concern, and it must be kept up. Those who contribute to keep it up and so subserve the public weal are rewarded. *This equity is enforced whenever suit is brought by the mortgagee to enforce his mortgage, and is held superior to the legal lien of the mortgage.* This doctrine was first distinctly set out in *Fosdick v. Schull*, 99 U. S. 235, and is sustained by a current of authority. * * * It seems to me that this claim comes within the principle and the protection of *Fosdick v. Schull*. *The court enforces this equity only as against the parties who seek its aid.* He who seeks equity must do equity. *So rigidly is this rule applied that when a receiver is appointed at the instance of a judgment creditor the material-man has no relief of this character, because as to such creditor there has been no diversion.* *Kneeland v. Trust Co.*, 136 U. S. 90. * * * In the present case the receiver was appointed upon the prayer and at the instance of the second mortgage creditors, and as against them the intervenor has an equity to have the moneys diverted to the payment of their interest restored from such portion of the earnings in the hands of the receiver as now or may become applicable to their interest. In case there are not now, and in the future there will not be, such earnings in the hands of the receiver, then the intervenors may be paid out of that part of the proceeds of sale of the mortgage property to be paid hereafter which shall be applicable to the second mortgage. * * * But the intervenor has no equity as against the first mortgage and other liens superior to the second mortgage. *These classes of creditors did not of their own volition come into equity, and the rule cannot be applied to them to do equity. They can stand on their legal vested lien.* True, in each instance they filed cross-bills by leave of the court. * * * it is evident that the cross-bill is a kind of defense,—a proceeding adopted by a party be-

cause he has been brought into court by the subpoena, and adopted in order that his whole right be adjudicated, since the complainant has forced him to put a part in adjudication. *This being so, the same equity does not arise against the first mortgage bond holders as against the second.*"

Bound v. South Carolina Railway Co., 47 Fed.
30.

From a consideration of these cases we submit the unquestioned rule to be that when the trustee is not the petitioner and does not institute an action of foreclosure the corpus of the property cannot be charged with the payment of indebtedness incurred prior to the receivership. It is immaterial whether the acts of the mortgagor have been fair to creditors or whether the necessities of the road at the time the receiver is appointed are great; the court lacks power to affect the corpus of the property.

The argument thus urged was not referred to in the opinion of the lower court. It was directly disapproved by the Master. The grounds upon which such disapproval were based were the following:

(1) No case has been cited in which priority was denied because the trustee was not the moving party.

(2) Property in the hands of the receiver is a trust fund which will be administered by a court of equity, and creditors having equitable rights therein will be protected.

(3) The trustee did seek the aid of a court of equity in this case.

We shall consider these arguments in the order named.

As to the first, while it is true that, in no Supreme Court decision has priority been denied prereceiver-ship debts because the proceedings were not initiated by the trustee, it is nevertheless true that, in the *Kneeland* case, debts of the receivership itself were denied for that, as well as other reasons, and that, in the decision in the *Bound* case, previously cited, the fact that the trustee had not invoked the aid of the court was the express and only ground for the decision. The incorrectness of the rule, even if this were not so, would hardly be demonstrated by a failure to find a case applying it in view of the very certain and unambiguous language employed in *Fosdick v. Schall*, and the cases which follow it.

The second ground ignores the, to our minds, very important consideration that, whereas equity will "administer a trust fund and sweep the field," it will not, in such administration, disregard "the sanctity of contract obligations." It is obvious that the trustee has a prior lien which will be respected and enforced under ordinary circumstances. It seems to us illogical to say that equity will prefer creditors who are entitled to equitable rights, irrespective of who the moving party is, when the rights of such creditors arise from and depend upon the action of the trustee in invoking the aid of a court of equity. We think the Master has not appreciated that creditors, so far as the trustee is concerned, have no rights superior to the mortgagee

until the aid of a court of equity is asked and a receiver appointed.

The third reason assigned is that the trustee has, in fact, in this case sought the aid of a court of equity and thus brought itself within the operation of the rule. This conclusion is predicated upon the fact that, when the receiver filed his petition for sale, the trustee filed its cross-petition asking that it be allowed to sell the property in accordance with the terms of the trust deed, that the cross-petition was granted, and that the court made its order confirming the sale.

If this action on the part of the trustee does constitute such a going into equity as to warrant the chancellor in displacing its lien, it necessarily follows that no trustee can ever invoke the rule announced in *Fosdick v. Schall*, and that his lien may be in every instance postponed. Where an unsecured creditor institutes an action in which the trustee is made a party defendant the trustee must protect himself in the forum which the creditor has chosen. In our case, when the receiver filed his petition for sale it was incumbent upon the trustee to lay before the court its rights and to ask that the sale be made in such a way that those rights would not be jeopardized. The trustee was not in any way invoking the discretion of the court or asking any equitable relief. It was merely asserting its legal rights. That was the purpose of the so-called "Special Appearance and Cross Petition," and the order of confirmation followed as a necessary consequence of the order of sale. Such a proceeding as that taken by the trustee in our case has repeatedly been held not

to constitute a going into equity, and the filing of a cross-bill is taken to be defensive in its nature, not an offensive step. The exact question was before the court, and determined adversely to the contention suggested, in

Bound v. South Carolina Ry. Co., supra,

from which we quote:

“A cross-bill is brought either to obtain a discovery of facts in aid of the defense to the original bill, or to obtain full and complete relief to all parties as to the matters charged in the original bill. It cannot introduce any matter not embraced in the original bill, for it is auxiliary to the proceedings in the original suit, and is dependent upon it. The original and cross-bills are so intimately connected together that they constitute but one suit. *Ayres v. Carver*, 17 How. 591; *Shields v. Barrow*, Id. 130; *Field v. Schieffelin*, 7 Johns. Ch. 250. The dismissal of the original bill will dismiss the cross-bill. *Dows v. Chicago*, 11 Wall. 108; *Cross v. DeValle*, 1 Wall. 5; *Milwaukee & M. R. Co. v. Milwaukee & St. P. R. Co.*, 6 Wall. 742. It is evident that the cross-bill is a kind of defense,—a proceeding adopted by a party because he has been brought into court by the subpoena, and adopted in order that his whole right be adjudicated, since the complainant has forced him to put a part in adjudication. This being so, the same equity does not arise against the first mortgage bondholders as against the second.”

Neither an appearance by the trustee, who is joined as a party in a proceeding initiated by an unsecured creditor, nor the fact that, after being made a party, it files a cross-bill for the protection of its rights, warrants a court of equity in subordinating the trustee's

lien upon the corpus of mortgaged railroad property, to the rights of general unsecured creditors.

Conclusion.

It is submitted that the decree of ~~December~~ ^{July} 18, 1913, should be reversed for the following reasons:

(1) No claimant is entitled to priority because the trustee did not commence an action of foreclosure or secure the appointment of a receiver, or submit itself to the operation of the rule that he who seeks equity must do equity.

(2) There is no proof that any current income was diverted during the six months' period after the indebtedness of any claimant herein became payable.

(3) The diversion in this case was \$30,000, and the lower court allowed priority to claims aggregating \$48,571.42.

Respectfully submitted,

EDWARD J. McCUTCHEN,

GAVIN McNAB,

A. CRAWFORD GREENE,

*Attorneys for Charles C. Moore,
F. W. Bradley, Maurice Schweitzer,
R. D. Robbins and Walter S.
Martin.*

McCUTCHEN, OLNEY & WILLARD,

Of Counsel.

No. 2353

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROB-
BINS and WALTER S. MARTIN,

Intervenors and Appellants,

vs.

F. L. DONAHOO et al,

Appellees.

**BRIEF FOR APPELLEES REPRESENTED BY
SULLIVAN & SULLIVAN AND
THEO. J. ROCHE.**

On behalf of some sixty-four men who rendered services in the operation and maintenance of the Ocean Shore Railway within the six months' period immediately preceding the appointment of the receiver herein, and whom we have represented during the entire proceedings, we respectfully submit the following points and authorities, in support of the decree of Judge Van Fleet, according to these and other workmen priorities as against the bondholders.

Position of Appellants' Counsel.

As the conclusion from their extended argument, counsel present the following propositions which they claim are involved in the appeal (p. 94):

“(1) No claimant is entitled to priority because the Trustee did not commence an action in foreclosure or secure the appointment of a Receiver or submit itself to the operation of the rule that he who seeks equity must do equity.

(2) There is no proof that any current income was diverted during the six months' period after the indebtedness of any claimant herein became payable.

(3) The diversion in this case was \$30,000 and the lower court allowed priority to claims aggregating \$48,571.42.”

The position of appellants' counsel therefore is that labor claimants whom we represent are not entitled to any relief in this action because the same was not commenced by the bondholders or their trustee. Furthermore, that if any relief be within their reach, it is confined to the amount of the diversion,—\$30,000, as found by the Master.

I

THE SERVICES RENDERED BY THESE APPELLEES WERE
NECESSARY FOR THE MAINTENANCE OF THE OCEAN
SHORE RAILWAY AS A GOING CONCERN.

At pages 26-7 of the agreed statement, the following appears:

“The labor, materials and supplies for which priorities have been allowed by the findings in the report of the Master and by the decree of the District Court were in each instance *necessary to the business of the Ocean Shore Railway Company as a carrier of freight and passengers, and to the public service, and were absolutely necessary for the maintenance of the railway property and to keep it a going concern.*”

II.

“GOING CONCERN” THEORY AS DISTINGUISHED FROM “INCOME” THEORY.

The Master, in his very able opinion rendered in connection with his report, thus states the question involved, as viewed by him in the light of the authorities, at pages 1 and 2 of his opinion.

“The question involved in this case is that of discovering upon what principles and under what limitations an unsecured creditor of an insolvent railroad in the hands of a court of equity may displace a previously vested mortgage lien given to secure bonds, and covering *all* property and *all* income in specific terms. That a priority will be allowed to such an unsecured creditor in certain cases is well settled. * * *

The cases are in substantial agreement as to the powers of a court of equity which has taken possession of a mortgaged railroad by its receiver. In any case where a receivership has properly come about it is agreed that the court in its administration of the trust thus imposed upon it must observe the peculiar nature of the property as *one requiring con-*

tinued operation, and must keep it running as a going concern to serve the public and preserve its integrity as a railroad (italics ours); in doing so the court will charge the expense thereof in the first place to its income, so that the body of the property may be, if possible, preserved intact for the mortgagees, but *in case of necessity will charge its expenses secondly to the corpus of the property*. It is unnecessary to consider the limits of the courts' power in this regard since the question of claims against the receiver does not arise upon this reference.

The question before us in this reference concerns only pre-receivership debts. Here there is a wide divergence of principle in the courts of the United States. It may be said, however, that decisions will fall in either one of two classes, one based upon what I may call the 'income' theory and the other upon what may be called, for lack of a better term, the 'going concern' theory. Both emphasize the necessity of keeping the railroad a going concern as an element in the question, both recognize that the income of the road must be first applied to the payment of such claims as are allowed priority. There is also a substantial agreement among all the courts as to the requisites which will entitle any claim to priority. The divergence arises in the limitations made in determining the fund out of which priority will be awarded; the courts of the first class allow it only out of income, or, in the alternative, if the income of the road has been diverted to the benefit of the mortgagees, out of the corpus of the property or the proceeds of its sale to the extent of such diversion and no further. The courts which follow the going concern theory, while making income or diverted income the primary fund, allow, never-

theless, the payment of priorities out of the property in the absence both of income and diversion. In the case of the Ocean Shore Railway Company there exists no income out of which payment can be made. A diversion is claimed, and it will be one of the questions involved in this reference whether such diversion has been proven, and to what extent. In the event, however, that diversion should not have been proven, or that it shall not be sufficient to allow full payment to claimants entitled to a priority in equity, it naturally becomes of prime importance to claimants to establish the correctness of the theory upon which the courts of the second class named have proceeded. Such decisions as have been made in the Ninth Circuit belong to the class that regards income or diversion as immaterial factors. It is claimed, however, that these decisions are not only in accordance with prior decisions of the Supreme Court, but are overruled by the latest decision of that court in *Gregg v. Mercantile Trust Company*, reported in 197 U. S. That case, however, in the facts before it, concerned only one class of claims, that is supply claims, and in that regard it is contended that its principles do not govern other classes of claims such as those of railroad operatives."

As shown by the above quotation of the language of the Master, one question here presented is whether the doctrine on this subject of priorities as against the mortgage bondholders, as heretofore recognized in this district, is still to prevail. The Master and the district judge disagreed as to the conclusion reached by the Master on the subject of the "*going concern*" theory as heretofore

recognized in this district. Judge Van Fleet, in his opinion, said:

“The Master has reached a conclusion, briefly stated, that the question of priorities for such claims depends entirely upon the question of diversion, that is, diversion of the current income fund; and he has held that neither laborers’ claims nor the claims of materialmen can be allowed preference over the rights of the bondholders except in an instance where it appears that there has been such diversion used for the benefit of the mortgagees in some way that has resulted to their substantial benefit; in other words, that if the current income which is to be looked to and treated as a trust fund for the payment of current expenses, has been diverted to the payment of interest on the mortgage debt, or for other purposes which has gone to the benefit of the corpus and resulting in a substantial betterment of the property, then the claims of laborers and materialmen may be given priority to the extent of such diversion; but not otherwise.

But unfortunately for that view the *courts have not given it practical application; they have in fact in every instance thus far occurring, where the question has come up, allowed for one reason or another priority to laborers’ claims that had been incurred for the essential purpose of keeping the road in operation; and it appears that in this circuit that principle has in several cases been distinctly announced and affirmed by the Circuit Court of Appeals. That court has held that in such instances the requirement of keeping the road a going concern is one which is paramount to the consideration whether or not there has been a diversion; evidently proceeding upon*

the theory that in the maintenance of this character of property it is so absolutely essential as lending it value to keep it in operation that *they will allow as a preference claims which grow out of the work of laborers* and that class of materials, which in their *essential nature go to maintain the operation of the road*, such as fuel oil, coal, lubricating oils, and water for steam and other essential purposes, notwithstanding it appear that there is in the particular instance no diversion of the current fund shown.

Now, the Master, giving due consideration from his point of view to this class of cases has nevertheless reached a conclusion that the principles there followed are necessarily overruled in the most recent case from the Supreme Court of *Gregg vs. Metropolitan Trust Company*, in the 197 U. S., an opinion written by Mr. Justice Holmes. I have given that case very careful consideration, and while the reasoning of the court is such as to lend considerable weight to the views of the Master as deduced therefrom, I am nevertheless not satisfied that the case so clearly contravenes the doctrine that has been established in this Circuit that I would be at liberty to assume that it necessarily overrules it. Of course, it is well established that this court is bound to follow the principles enunciated by the Circuit Court of Appeals of its circuit unless it is enabled to see clearly that those principles have been unquestionably overturned by later decisions of the highest tribunal. While Judge Holmes in *Gregg vs. Metropolitan Trust Company* bases his conclusion upon considerations which, as I say, may be regarded as lending strong color to the views of the Master, *he nevertheless makes use of references to previous decisions allowing laborers' claims, in a manner to in-*

dicute that he apparently regards the latter as not being fully within the principles he is there applying. I am unable, therefore, to reach the conclusion that the rule established in this Circuit has been distinctly overturned by that decision, and that being so I am forced to the conclusion that the result reached by the Master must be overruled in that one particular."

III.

EVEN IN THE ABSENCE OF A DIVERSION OF CURRENT DEBTS, THE DAY TO DAY LABORERS ENGAGED IN OPERATING THE ROAD AND WHOSE LABOR IS INDISPENSABLE TO THE BUSINESS OF THE ROAD ARE ENTITLED TO PRIORITY AGAINST THE BONDHOLDERS, OR PURCHASERS, ON A SALE OF THE PROPERTY.—THE GREGG CASE HAS NOT OVERRULED EITHER MILTENBERGER V. LOGANSPORT RY., 106 U. S. 286, NOR UNION TRUST CO. V. ILLINOIS MIDLAND RY., 117 U. S. 434.

The most important case decided by the Supreme Court of the United States bearing upon this question of priorities is

Miltenberger v. Logansport etc. Ry. Co., 106 U. S. 286; 27 Law Ed. 117.

In the Miltenberger case, Mr. Justice Blatchford, speaking for an undivided court on the subject of equitable priorities, at page 311 (U. S. Rep.), said:

“In respect to the \$10,000 due other and connecting lines of road for materials and repairs, and for ticket and freight balances,
* * * the first petition stated that pay-

ment of that class of claims was *indispensable to the business of the road*, and that, unless the receiver was authorized to provide for them at once, *the business of the road would suffer great detriment*. These reasons were satisfactory to the court. * * * Many circumstances may exist which may make it *necessary and indispensable to the business of the road* and the preservation of the property, for the receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, or even *the corpus of the property*, under the order of the court, with a priority of lien. * * * It is easy to see that the payment of unpaid debts for operating expenses, accrued within ninety days, due by a railroad company suddenly deprived of the control of its property, *due to operatives in its employ, whose cessation from work simultaneously is to be deprecated*, in the interests both of the property and of the public, and the payment of limited amounts due to other and connecting lines of road for materials and repairs and for unpaid ticket and freight balances, *the outcome of indispensable business relations*, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, the general consequence involving largely, also the interests and accommodation of travel and traffic, may well place such payments in the category of payments to *preserve the mortgaged property* in a large sense, *by maintaining the good will and integrity of the enterprise, and entitle them to be made a first lien.*"

1 The court in that case upheld the provision allowing the receiver to pay arrears due for oper-

ating expenses, *including laborers' claims for a period in the past not exceeding ninety days.*

The next case to which we call the attention of the court on this point, and one perhaps more frequently cited is

Union Trust Co. v. Illinois Midland R. Co.,
117 U. S. 434; 29 Law Ed. 963.

In that case the court held, as shown in the eighth subdivision of the syllabus:

“That certificates issued to replace earnings diverted from paying for operating expenses and ordinary repairs, to pay for necessary betterments or improvements, leaving large debts on account of such expenses and repairs, are entitled to priority.

(sub.) “9. That, in view of the facts of the case, the Paris and Decatur bondholders cannot insist that the want of affirmative assents by them or their trustee deprived the court of power to create, on the corpus of the property, any lien taking priority over the mortgage lien.

“10. That while the ordinary expenses of the receiver in operating the road are first payable out of income, if any, the *corpus* may be resorted to when the items are proper, after scrutiny and opportunity for those opposing to be heard.

“11. That wages due the employees of the Illinois Midland Company within six months immediately preceding the appointment of the first receiver, were properly allowed priority.

“12. That the terms of the orders appointing the various receivers did not impair or exclude the ample authority of the court to order said ordinary expenses and ‘six months’ labor

claims', paid out of the property itself, with priority."

The opinion of an undivided court in that case, as we have seen, was by Mr. Justice Blatchford.

At page 448 (Law Ed. 968) Justice Blatchford says:

"Many of the contested questions in these cases arise out of the transactions of the receiver originally appointed and his successors, especially in issuing receiver's certificates; and the contest, as presented to this court, is substantially one between the Paris and Decatur bondholders on one side, and those who claim a priority of lien over the bonds on the other."

At page 451 (Law Ed. 969) the court says:

"The final decree declares that the lien of the Paris and Decatur bonds is subject to certain receiver's certificates of the 8th, 12th, 14th, 16th 17th and 18th series, which are to have priority in payment of the Paris and Decatur bonds, out of the proceeds of sale of the Paris and Decatur road, and which amount, with interest to January 15, 1885, to \$200,408.87."

At page 464 (Law Ed. 973) the court says:

"The appellants Borg and others also complain of provisions in the final decree, giving priority over the Paris and Decatur bonds to just and equitable proportions of the following items:" (enumerating five different classes of allowance, and specifying the amounts, and giving as a sixth class) "6. *Amount of wages due employees of the Illinois Midland Company within six months immediately preceding the appointment of the first receiver, as shown by*

schedule H of the report; such equitable proportions of the receivers' indebtedness and of the *six months' labor claims* to be ascertained in the manner provided by the decree.

"As to items 1, 2, 3, 4 and 5; while it is admitted that these debts were incurred for the ordinary expenses of the receivers in operating the road, it is contended that they are entitled to priority only out of the income of the road, and not out of the proceeds of the property itself. Of course, *such items are payable out of income, if any, before the corpus is resorted to, but that may be resorted to when the items are proper ones to be allowed for operating expenses, after scrutiny and opportunity for those opposing to be heard.* This view is in accordance with the principles above laid down and the authorities above cited" (among the cases cited, was the Miltenberger case).

"It is contended, however, that, in the order of September 11, 1875, appointing Dole receiver, while authority was given to him to carry on the business of the road and to make repairs and additions essential to its interests and safety, it was provided that, out of the moneys he should receive from its operations, he should pay for the expenses of operation; that he was not authorized by that order to contract any debt which the receipts of the road would not pay; that the terms of the order were such as to exclude the payment of any of the expenses embraced in the six items above named" (including labor claims) "out of any fund other than the receipts from the operation of the road; and that the orders appointing Rees and Genis were equally limited. But we think *this view is not correct.* The terms of these orders do not impair or exclude the *ample authority* which the *court would otherwise have,*

and otherwise has, to order the claims in question to be paid out of the property itself, with priority.

“The claims embraced in the *six items* have been carefully scrutinized and reported on favorably by the commissioner, and allowed by the circuit court, within and in accordance with the principles above laid down, and *we think that all of them, including the ‘six months’ labor claims,* were properly allowed.”

This case clearly lays down the proposition that labor claims accrued within the six months’ period are properly chargeable against the corpus of the railway’s property, and we again call the attention of the court to this language of Justice Blatchford:

“Of course, such items are payable out of the income, if any, before the corpus is resorted to, but that may be resorted to when the items are proper ones to be allowed for operating expenses.”

The principle that the various employees through whom the actual operation of a railway is carried on have a peculiarly equitable claim is recognized in

Thomas v. Western Car Co., 149 U. S. 112;
37 Law Ed. 669,

where Mr. Justice Shiras says:

“The case of a corporation for the manufacture and sale of cars, dealing with a railroad company, whose road is subject to a mortgage securing outstanding bonds, is very different from that of *workmen and employees or of*

those who furnish, from day to day, supplies necessary for the maintenance of the railroad."

In

Blair v. St. Louis etc. R. Co., 22 Fed. 472, claims for labor and supplies accrued within six months of the appointment of the receiver were allowed priorities against the income, and furthermore, as shown by subdivision 4 of the syllabus:

"4. *Semble*; that claims entitled to preference as to income, may, in exceptional cases, and where a special equity appears, be made a first lien upon the corpus of the mortgaged property."

In a note following this case, we find the following:

"There are only two exceptions so far as ante-receivership debts are concerned, to the general rule as to the superiority of the mortgage lien; the first is that, where current earnings have been used by the officers of a company for the benefit of mortgage creditors in paying bonded interest, purchasing additional equipments, or making permanent improvements on the fixed property, the mortgage security is chargeable, in equity, with the restoration of the fund thus improperly diverted. The second exception is that, where it is necessary to pay employees back wages in order to retain their services, or to pay a debt for ante-receivership operating expenses, in order to maintain business relations with the claimant, and the retention of such employees, or *the maintenance of such relations, as the case may be, is indispensable to the welfare of the road, and such debts cannot be paid out of income, the*

receiver may be authorized to raise the necessary funds by issuing certificates of indebtedness which shall take precedence of first mortgage bonds."

Of course, the issuing of receiver's certificates and giving them priority as against the first mortgage bonds is the exact equivalent of paying out of the proceeds of the sale in the receiver's hands, the amounts due preferred creditors.

As against the well established doctrine of the Miltenberger and Union Trust Company cases, counsel for appellants place absolute reliance upon the case of

Gregg v. Metropolitan Trust Co., 197 U. S. 183; 49 Law Ed. 714.

They claim that the rule of the earlier cases allowing priority to a day laborer for services rendered to the company within six months has been overruled. The Gregg case has no such effect. It could not so hold because *the priority of a labor claim was not involved either directly or incidentally in the question there before the court.* The claim there was a supply claim as distinguished from a labor claim, but even as to a supply claim, the decision does not overrule the well established doctrine of earlier cases where the supplies were necessary to the business of the road. The claim in the Gregg case was for railroad ties on hand when the receiver took charge of the railway property. The Circuit Court of Appeals had disallowed

the claim of priority and the claimant sought by certiorari to review the ruling. Counsel for the respondent to the writ, in his brief, took the position that "while this court may sometimes have permitted the payment of a current claim out of the proceeds of sale without proof of diversion, those were exceptional cases."

The opinion of the majority of the court is by Mr. Justice Holmes. At page 187 (49 Law Ed. 718) he says:

"The case principally relied on for giving priority to the claim for supplies is *Miltenberger v. Logansport, C. & S. W. R. Co.*, 106 U. S. 286, 27 L. ed. 117, 1 Sup. Ct. Rep. 140. But, while the payment of some pre-existing claims was sanctioned in that case, it was expressly stated that 'The payment of such debts stands, prima facie, on a different basis from the payment of claims arising under the receivership.' The ground of such allowance as was made was not merely that the supplies were necessary for the preservation of the road, but that the payment was *necessary to the business of the road*,—a very different proposition. * * * In *Union Trust Co. v. Illinois Midland R. Co.*, 117 U. S. 434, 465 * * * labor claims accruing within six months before the appointment of the receiver were allowed without special discussion, but the principles laid down in the *Miltenberger* case had been repeated in the judgment of the court, and the allowance was said to be in accordance with them."

In our quotation from the Union Trust Company case we have endeavored to show above that the

question of priority of labor claims against the corpus of the property was distinctly raised in that case and just as distinctly passed upon. Continuing, after referring to another earlier case, Justice Holmes says:

“But the payment of the employees of the road is more certain to be necessary in order to keep it running than the payment of any other class of previously incurred debts.”

Counsel for claimant had insisted that his supply claim was as much entitled to priority as labor claims accruing at the same time, and *payment of which had been allowed*. In speaking of this phase of the claimant's contention, the court said:

*“It is not necessary to answer this contention at length. The original order gave the petitioner no such rights as he asserts. It would have been a stretch of authority for the receiver, in his discretion, to apply the borrowed money to this debt. * * * The petition on which the original order was made stated that the money was wanted to pay certain obligations ‘or so much thereof as may be necessary’, embodying the distinction which we have drawn from the cases. We already have intimated that the payment of railroad hands might stand on stronger grounds than the payment for past supplies; and, if the payment was wrong, it would not be righted by making another, less obviously, within the scope of the decree.”*

A careful analysis of the opinion will show in the first place that the labor claims accruing within the six months' period had already been allowed

and paid out of the funds in the hands of the receiver. In the second place, the opinion shows that "*the payment of the employees of the road is more certain to be necessary in order to keep it running than the payment of any other class or previously incurred debts.*" In other words, the laborers are "*necessary to the business of the road.*"

As said by Justice Holmes, "*the payment of railroad hands might stand on stronger ground than the payment for past supplies.*" Furthermore, neither the Miltenberger case, 106 U. S., nor the Union Trust Company case, 117 U. S., in which labor claims accruing within six months were allowed, is in terms, or inferentially, overruled by the Gregg case. As we take it, the Gregg case may stand unquestioned, and yet a claim for supplies necessary to the business of the road or labor furnished in the actual carrying on of the business of the road may still rightfully demand priority on equitable grounds even as against the *corpus* of the railway property.

If we allow the Gregg case full sway as authority, notwithstanding its seeming variance with the doctrine stated in *Southern R. Co. v. Carnegie Steel Co.*, 176 U. S. 257, we still insist that *labor claimants*, such as those whom we represent, are entitled to priority not merely as against the earnings, but as against the property itself, or its proceeds, on the ground that the labor of such

claimants was *necessary to the business of the road*, and that labor thus rendered serves as the basis of an equitable priority against the bondholders and the purchasers.

IV.

THE CASES OF MILTENBERGER V. LOGANSPOET ETC. R. CO., 106 U. S. 286, AND UNION TRUST CO. V. ILLINOIS MIDLAND R. CO., 117 U. S. 434, WERE NOT CASES OF DIVERSION, NOR WERE THEY OVERRULED BY GREGG V. METROPOLITAN TRUST CO., 197 U. S. 183-197.

Neither the Miltenberger case nor the Illinois Midland case was in terms, nor by necessary inference, overruled by the Gregg case. In the opinion of Mr. Justice Holmes in the Gregg case, however, this language is found:

“In Union Trust Co. v. Illinois Midland R. Co., 117 U. S. 434, 465, 29 L. Ed. 963, 973; 6 Sup. Ct. Rep. 809, labor claims accruing within six months before the appointment of a receiver were allowed without special discussion, but the principles laid down in the Miltenberger case had been repeated in the judgment of the court and the allowance was said to be in accordance with them.

It would seem from St. Louis A. & T. H. R. Co. v. Cleveland C. C. & I. R. Co., 125 U. S. 658 * * * that in both those cases there was a *diversion of earnings*. *The payment of the employees of the road is more certain to be necessary in order to keep it running, than the payment of any other class of previous incurred debts.*”

In the assumption of Mr. Justice Holmes as to the fact that diversion was shown in the cases referred to, he was manifestly in error as to the fact. Such false assumption as to a matter of fact involved in a record not before the court should have no efficacy to overrule the legal principles clearly and distinctly laid down in the two cases referred to. Appreciating the importance of the rulings in the Miltenberger and Illinois Midland cases, appellants' counsel at pages 32 and 44 of their argument, emphasize the erroneous assumption of fact made by Mr. Justice Holmes in his opinion. The reports of the cases we have above called to the attention of the court show no diversion. Certainly the rulings announced by the court in each case were in no sense based on diversion as an established fact. Our position in this regard is fully borne out by the opinion of the Master, on file herein. At page 22 of that opinion, the Master says, in referring to the Miltenberger case:

“I further remark before leaving this case that *while Justice Holmes in the Gregg case has suggested that a diversion of funds appeared in the Miltenberger case, it is not clearly shown that such was the case.*”

At page 36 of the same opinion, in referring to the case of *Union Trust Co. v. Illinois Midland R. Co.*, 117 U. S. 434, the Master says:

“In this case *there does not appear to have been any diversion of income except such income as was diverted by the receiver and was made good by receiver's certificate to the*

amount of the diversion. It does not appear that six months' pre-receivership labor claims were required to share pro rata in the amount of the fund realized from the receiver's certificate issued to restore this diversion, and *it affirmatively appears that these six months' labor claims were allowed priority against the corpus.*"

At pages 42-3 of his opinion, the Master discusses the case of *St. Louis A. & T. H. Railroad Company v. Cleveland C. C. & I. Railroad Co.*, 125 U. S. 658. He refers to the bearing of that case on the question before him as containing a statement that the Miltenberger case and the Illinois Midland case were cases where a diversion had been shown. He thus characterizes that statement:

(p. 43) "This statement is referred to as authority and apparently with approval by Justice Holmes in the Gregg case, as will hereafter be seen. I pause to remark again that the court seems in error as regards the fact of diversion in both the Miltenberger and the Illinois Midland case" (see brief pages 22, 36).

Again, at page 77, in referring to the two cases in question, the Master says:

"So far as concerns Justice Holmes' interpretation of the Miltenberger case, and the Illinois Midland case, as being cases where there was a *diversion of earnings*, it must be acknowledged that the reports of those cases do not anywhere indicate such diversion, and, as has been above pointed out (p. 24) it is seen in the opinion in *Union Trust Company v. Southern R. Co.*, decided in the same term

as the Miltenberger case, that *that case was not regarded as a case of diversion of earnings.*”

V.

PRIORITY OF LABOR CLAIMS AS AGAINST THE BONDHOLDERS, MAY BE ASSERTED IN OTHER ACTIONS THAN THOSE INSTITUTED FOR FORECLOSURE OF THE MORTGAGE BY THE BONDHOLDERS OR TRUSTEES.

In some of the early cases decided by the Supreme Court of the United States, the suggestion was made that a reason for allowing the assertion of the equitable superiority of the labor or supply claimants' demand over that of the bondholders was based on the fact that the bondholder himself was seeking the aid of a court of equity to establish his claim, and therefore, seeking equity, he should do equity. Stating the proposition in this form involves the idea that the demand of the labor or supply claimant was itself based on equity or on equitable considerations.

The equity which is asserted and recognized in these cases on behalf of those whose labor or materials assist in *keeping the railway property a going concern*, inheres in the very character of the claim, rather than the character of the action in which such equity is asserted.

It is not essential to the assertion of such equitable claim that the action wherein it is asserted, be one instituted for the foreclosure of mortgage. This proposition has been repeatedly determined

in the federal courts and particularly in the Supreme Court of the United States.

In this connection, the first case to which we invite attention is

Union Trust Co. v. Illinois Midland Ry. Co.,
117 U. S. 434-441-3, 458; 29 Law Ed. 963-
6-8, 971-2.

Among the points determined by the court in that case, as shown by the syllabus (Law Ed. 963) is the following:

“2. That the power of a court of equity having charge of railroad property to make necessary repairs does not depend upon the consent of those interested, nor upon prior notice to them. * * *

“4. That the bill filed in the state court by Hervey (the holder of a majority of the stock of the corporations), and certain judgment creditors, was sufficient to enable the court to administer the property as a trust fund and marshal the debts, making proper parties before adjudging the merits.”

In the statement of the facts by Mr. Justice Blatchford (Law Ed. 965-6) we find the following:

“On the 11th of September, 1875, Robert G. Hervey and two other parties filed a bill in equity in the Circuit Court of Edgar County, Illinois, against the Illinois Midland Railway Company. It set forth that Hervey owned a majority of the stock of the corporations above named, and that the other plaintiffs were judgment creditors of the Paris and Decatur Company, with executions returned unsatisfied; * * * that certain creditors and stockhold-

ers of the Paris and Decatur Company, a minority in number and amount, were threatening to have the Illinois Midland Company and its property placed in the hands of a receiver; that the plaintiffs represented a majority of the stock in all of the corporations, and desired to have a receiver of the franchises, railways and rolling stock of the corporations appointed immediately and without further notice, or the rights of the creditors and stockholders would be irreparably prejudiced."

The bill also set up that negotiations were pending toward reorganizing the affairs of the railway company, and generally, that it was necessary in the interests of all concerned that a receiver should be appointed to handle the affairs of the railway company.

Justice Blatchford continues:

"The prayer of the bill was that a receiver be appointed of all the rights and franchises of the Illinois Midland Company, and of all the property in its control; and that an account be taken of all the claims, liens and liabilities of its stockholders and creditors, and of those of the corporations above named, and they be ordered to be paid and adjusted, as the respective rights and interests of such stockholders and creditors should appear; and for further and other relief, according to equity."

(p. 443; Law Ed. 966) "On the same day the Illinois Midland Company appeared to the bill by attorney, and waived notice and submitted itself to the court for such order in the premises as might in equity be right and proper; and the judge of the court, at chambers, made an order appointing as receiver

George Dole, of Paris, and requiring him to give a bond for \$75,000, with security and then to 'forthwith take possession of all the personal, real and mixed property of every kind belonging to or in the possession of said Illinois Midland Railway Company, including the property formerly owned and possessed by the Peoria, Atlanta and Decatur Railroad Company, the Paris and Decatur Railroad Company, and the Paris and Terre Haute Railroad Company; and if necessary to sue for, in the name of said receiver, and recover, all the property of said company or companies, whether real, personal or mixed, and whether in possession or in action.'

The order empowered the receiver to carry on the business of the railway companies mentioned, subject to the direction of the court, until their respective rights could be fully ascertained.

On October 16th, 1875, an amended bill was filed in which a number of other plaintiffs were joined with Hervey, some of whom were bondholders of the Illinois Midland, and some, holders of bonds in the Paris & Decatur Company. On the 5th of December, 1876, the Union Trust Company filed a bill in the Circuit Court of the United States, for the Southern District of Illinois, against the corporations involved, to foreclose the several mortgages made to the Union Trust Company. In 1877 the Union Trust Company was by an order of court, made a party defendant in the original Hervey suit. On February 15, 1878, the Union Trust Company filed a bill in the Circuit Court,

for the Southern District of Illinois, against the Paris & Decatur Company, and the Illinois Midland Company to foreclose the Paris & Decatur mortgage. On the same day, the Union Trust Company filed a bill in the same federal court against the Paris & Terre Haute Company, and the Illinois Midland Company to foreclose the Paris & Terre Haute mortgage. On the same day Secor filed a bill in the same federal court against the Illinois Midland Company to foreclose the Peoria, Atlanta and Decatur mortgage. On April 6, 1878, the original Hervey suit commenced in the state court was, on petition filed by the Union Trust Company, removed into the federal court, and on the 13th of August following, the suits brought by the Union Trust Company and by Secor for the foreclosure of the mortgages were consolidated by order of the federal court. Other actions also were brought involving some sections of the controversy.

At page 448 (Law Ed. 968) the report says that

“Many of the contested questions in these cases arise out of the transactions of the receiver originally appointed and his successors, especially in issuing receiver’s certificates; and the contest, as presented to this court, is substantially one between the Paris and Decatur bondholders on one side, and those who claim a priority of lien over the bonds on the other.”

Objection was urged upon the court in various forms that the mortgaged property should not be

subjected to claims urged against the railway properties growing out of the appointment of receivers, and the issuance of receiver's certificates in actions to which the mortgagees or trustees were not parties at the time of the appointment of the receiver, or the making of the order for the issuance of the receiver's certificates.

After an extended discussion of the question and reference to the cases of *Wallace v. Loomis*, 97 U. S. 146; *Miltenberger v. Logansport R. Co.*, 106 U. S. 286; and *Barton v. Barbour*, 104 U. S. 126, Mr. Justice Blatchford, at page 458 (Law Ed. 971) goes on to say:

“In this connection it is objected that in those cases the suits were foreclosure suits brought by trustees under mortgages, and that a different rule should obtain in a case where the trustees or the bondholders do not come into court initially, asking the aid of equity in the appointment of a receiver. It is said that the *Hervey* suit was not such a suit. But the coplaintiffs with *Hervey* were judgment creditors of the Paris and Decatur Company, with executions returned unsatisfied. The bill set out the precarious condition of all the property held and used by the Illinois Midland Company, and the necessity for a receiver in the interest of all the creditors of all four of the corporations, to prevent the levy of executions on such property; and it prayed for a judicial ascertainment and marshaling of all the debts of all the corporations, and their payment and adjustment as the respective rights and interests of the creditors might appear, and for general relief. The plaintiffs set forth that they represented a majority of

the stock in all the corporations. This bill was quite sufficient to enable a court of equity to administer the property and marshal the debts, including those due the mortgage bondholders, making proper parties before adjudging the merits."

The right of the court to appoint a receiver in the action brought by the stockholders and creditors, and the right to allow priorities to be asserted in such a suit as against the mortgage claims, was distinctly recognized.

Sage v. Memphis and Little Rock Co., 125 U. S. 376-7-8; 31 Law Ed. 694-8.

In that case, the action in which the receiver was appointed, was commenced by Russell Sage, a creditor of the company. In speaking of the appointment of the receiver, Mr. Justice Harlan said:

"This was done because, in the opinion of the court, the appointment of a receiver was necessary 'to protect plaintiff's interests and rights'."

In justifying the action of the lower court in appointing the receiver, Justice Harlan quotes the language of *Union Trust Co. v. Illinois Midland Co.*, 117 U. S. At page 376 (Law Ed. 698) he says:

"It is true, also, that Sage did not sue in behalf of all the creditors of the Company or of such as might come in and contribute to the expense of the litigation. He was not bound to pursue that course. It was his privilege, under the law, to sue for his own benefit,

and it was within the power of the court, for his protection as a judgment creditor, to place the property of the debtor Company in the hands of a receiver, for administration under its orders. We do not mean to say that a single judgment creditor or any number of such creditors of a railroad company are entitled, as matter of right, to have its property put in the hands of a receiver, merely because of its failure or refusal to pay its debts. Whether a receiver shall be appointed is always a matter of discretion, to be exercised sparingly and with great caution in the case of quasi public corporations operating a public highway, and always with reference to the special circumstances of each case as it arises. All that we say in this connection is that, under the circumstances presented in this case, the appointment of the receiver was within the power of the court."

The lower court had directed that the net earnings of the road during the receivership, should be turned over to the trustees holding the mortgage of the railway property. A claim had been made that the action instituted by Sage was collusive, and the Master to whom the matter had been referred, had made a finding that the action was in fact collusive. In referring to this question, the Supreme Court says:

"But it is contended that the suit instituted by Sage was collusive and an imposition upon the court; that, as held by the circuit judge, when the receiver was discharged, after having served seventeen months, and the property was turned over to the Company, the process of the court was not used 'in good faith to

collect complainant's judgment, but as a means of placing the property and business of a railroad company in the hands of the court, to be managed through a receiver, to the end that the defendant may not be subject to suits in the ordinary course of judicial proceedings, and in order to enable the plaintiff and defendant, by agreement between them, through the receiver, to apply all the earnings of the road during a series of years to the improvement and betterment of the property;' and that, consequently, the proceeding was not, in fact, an adversary one."

The court reviews the cases, discusses the facts involved, and finally reverses the action of the lower court. Neither the fact that the action was a creditor's action, nor that the bringing of the suit was found to be collusive prevented the court from making a proper disposition of the funds collected during the period of the receivership.

At the close of the opinion we find the following:

"For the reasons stated we are of the opinion that the decree below was erroneous in that it did not, in the order directing the distribution of the fund remaining in court, give a preference to the judgment at law obtained by the appellant Sage.

The decree is reversed and cause remanded."

The doctrine of this case that a receiver may be appointed in a creditor's suit has been repeatedly recognized and approved in subsequent cases.

Southern Ry. Co. v. Carnegie Steel Co., 76
Fed. 496-8.

In that case, Simonton, Circuit Judge, speaking of the allowance of preferences against the mortgage claims, after referring to cases in which preferences have been allowed, goes on to say at page 496:

“If this be the law when a receiver is appointed at the instance of mortgagees, how much stronger is the equity when the receiver is appointed at the instance of stockholders, to secure uninterrupted opportunity for a satisfactory reorganization?”

The action of the Circuit Court of Appeals, as voiced by Simonton, judge, in the case just cited, was affirmed in the same case by the Supreme Court of the United States in 176 U. S. 258, 271. In the statement of facts by Justice Harlan for the Supreme Court of the United States (176 U. S. 258; 44 Law Ed. 459), it appears that the action originally was commenced by Clyde and others suing for themselves and other creditors and stockholders of the defendant railway corporation. Subsequently, an action was commenced by the Central Trust Company to foreclose the mortgage held by it as trustee. Subsequently that action was consolidated with the action instituted by Clyde and others. In the lower court, claims had been allowed growing out of the administration of the receiver in the Clyde suit. On the appeal, among the grounds urged for reversal, are these, noted in the briefs of counsel (Law Ed. 465):

“The consolidated bondholders did not apply for judicial aid or assert any demand for pos-

session, and received no interest from such first receivers (receivers in the equity suit), and should not be charged with the responsibility of their operation.”

And again,

“Until the mortgagees come into equity with their own application for entry they stand on their vested liens, and are in no way responsible, out of their contract security, for the court’s administration of the property.”

In answering the contentions on behalf of the bond holders, Mr. Justice Harlan said:

“These figures show that both during the receivership in the Clyde suit and the receivership in the foreclosure suit immense sums were expended in paying interest etc. * * * which should have been applied in payment of preferential claims.”

After quoting from the opinion of the Circuit Court of Appeals, Justice Harlan continues:

“Looking at the case in the light of the principle that a mortgagee cannot require from the mortgagor an account of the earnings, tolls, and income until he has made demand therefor or for a surrender of possession under the provisions of the mortgage (Sage v. Memphis & L. R. R. Co., 125 U. S. 361, 378, 31 L. ed. 694; Fosdick v. Schall, 99 U. S. 235) the Circuit Court of Appeals also said: ‘When, therefore, *the receivers appointed at the instance of stock holders* and creditors took possession, they enjoyed the same right to the earnings and income which the railroad company enjoyed, and rightfully received them. As the railroad company would have been bound to use this income in

the payment of the current expenses for labor and supplies, the receivers should have done so also.' "

The action of the Court of Appeals in allowing priorities growing out of the management of the receivership in the stockholder's suit, was approved, and the priorities there allowed, as we have heretofore shown in this argument, were approved by the Supreme Court of the United States.

New England R. Co. v. Carnegie Steel Co.,
75 Fed. 568.

The right of the court to appoint a receiver at the instance of a stockholder or bond holder in an action to which the mortgagee was not a party, was there distinctly recognized and it was held that a receiver so appointed stood in the place of the corporation, and might out of the earnings received, under the direction of the court, make expenditures as the corporation itself might have done but for the appointment of the receiver.

In

Clark v. Central Railroad Co., 66 Fed. 803, priorities were allowed in a consolidated action growing out of the conduct of the receiver appointed in a stockholders' suit. Pending the litigation, an action for foreclosure of the mortgage had been brought by the trustee. The action of the lower court in making the allowances was affirmed by the Supreme Court, the action there being entitled,

Virginia & A. Coal Co. v. Central R. B. Co.,
170 U. S. 355, 372; 42 Law Ed. 1068.

From the report of the case (170 U. S. 357; 42 Law Ed. 1069) it appears that the original action was instituted by a stockholder who asked for the appointment of a receiver. At page 370 (Law Ed. 1073) Mr. Justice White says:

“The circumstances that it is uncertain, from the terms of the stipulation, whether the expenditures for betterments were made by the receivers under the stockholders’ bill, or under the bill filed by the Central Company or under the trustee’s bill for foreclosure, is immaterial. Even though the mortgages securing the bonds provided for the sequestration by foreclosure of the income of the road for the benefit of the bondholders, for reasons already stated, that income until strict foreclosure or a sale of the road was charged with the prior equity of unpaid supply claimants such as those now before the court.”

Kneeland v. American Loan Co., 136 U. S. 98; 34 Law Ed. 383.

In that case the first receiver appointed was at the instance of a judgment creditor. Subsequently, a receiver was appointed in actions instituted by the trustees for foreclosure of mortgage. In discussing the appointment of receivers, and the obligations arising therefrom, the court said:

“A court which appoints a receiver acquires by virtue of that appointment, certain rights, and assumes certain obligations, and the expenses which the court creates in discharge of those obligations are burdens necessarily on the property taken possession of, and this *irrespective of the question* who may be the ulti-

mate owner, or *who may invoke the receivership.*"

Kneeland v. Bass Foundry, 140 U. S. 594-5-6;
35 Law Ed. 544-8.

The controversy there before the court arose out of the foreclosure proceedings of the same mortgage involved in the case last above cited. In discussing the obligations arising out of the appointment and action of a first receivership, the court said (594-5; Law Ed. 544):

"The objection urged to the item of \$1,695.01, which was for supplies furnished to the receiver Dwight, is, that Dwight was not the receiver for the bondholders and Kneeland, but was appointed receiver at the suit of a judgment creditor; that, so far as Kneeland and the bondholders are concerned the situation was precisely the same as if the company had remained in possession of the road up to the expiration of Dwight's receivership, December 1, 1883; and that therefore that item should not be entitled to a preferred lien over the claims of the bondholders. * * *"

(p. 596; Law Ed. 544) "As respects the supplies furnished the road in this case during the period of Dwight's receivership, the court below, in the exercise of its undoubted authority, ordered them paid out of the fund arising from the sale of the road, because, so far as the record shows, that was the only fund available; and they had been *necessary to the continued operation of the road*, and had gone into the general property covered by the mortgage which was sold at the foreclosure sale. They contributed to the preservation of the property during the receivership, and went towards swell-

ing the fund arising from the sale on foreclosure. Under such circumstances the court appointing the receiver was justified, under the rule laid down in *Kneeland v. American L. & T. Co.*, supra, in preferring such claim to the claims of bondholders whose property they assisted in preserving.”

The authority of these two cases last cited on this point is directly recognized in a decision made by Judge Van Fleet of this circuit, when he was justice of the Supreme Court of the State of California in the case of

Illinois T. & S. Bank v. Pac. Ry. Co., 115
Cal. 285, 295.

There the court said:

“But, moreover, when a court in a proper case, and under circumstances apparently authorizing such action, takes property into its possession through a receiver, which, as in this instance, is of a character to give the public a right to its continued operation and use, the court acquires a right and assumes the obligation of keeping such property in operation; and, for that purpose, is authorized to incur such expenses and create such obligations against the property as are necessary to keep the same in repair and pay operating expenses. And such expenses and obligations ‘are burdens necessarily on the property taken possession of, and this, *irrespective of the question who may be the ultimate owner, or who may have the preferred lien, or who may invoke the receivership.*’ (*Kneeland v. American Loan etc.*

Co., 136 U. S. 89; *Kneeland v. Bass Foundry etc. Works*, 140 U. S. 592)."

Veatch v. American Loan & Trust Co., 84 Fed. 274 (decided in the Circuit Court of Appeals, 8th circuit, on December 6th, 1897).

The opinion there was by Circuit Justice Brewer. At page 275 he says:

"Turning now to the question of law, it will be noticed that a railroad receivership may be at the instance of the mortgagee, or of a judgment creditor, or of a stockholder. If at the instance of the mortgagee, the income is impounded for its benefit; if of a judgment creditor, for the payment of his judgment. There is in the latter case an equitable levy on such income, and the mortgagee can claim no superior right thereto."

In support of his position, the court quotes the language of *Sage v. Railroad Co.*, 125 U. S., cited by us above.

Further along in the opinion, Justice Brewer says:

"The moment the court takes possession of property, certain equitable rights exist, which cannot be ignored by receiver or court. The property and the income received therefrom is taken possession of by the court for the benefit, according to certain equitable rules, of all parties in interest."

The court in that case ruled, as shown by subdivision 2 of the syllabus that

"A mortgagee of a railroad has no preferred right, above that of a judgment creditor, to

surplus earnings that have accumulated in the hands of a receiver appointed at the instance of stockholders prior to the filing of a bill for foreclosure.”

Among the many other cases sustaining the doctrine contended for in this subdivision of our argument we cite the following:

Horn v. Pere Marquette R. Co., 151 Fed. 626
(and cases cited);

Metropolitan Railroad Receivership, 208 U.
S. 90;

American Can Co. v. Erie Preserving Co.,
171 Fed. 540;

*Cleveland C. & S. Ry. Co. v. Knickerbocker
Trust Co.*, 86 Fed. 77-8;

Central Trust Co. v. Wabash Ry., 30 Fed.
332;

*International Trust Co. v. Townsend Brick
Co.*, 95 Fed. 850;

Blair v. St. Louis R. Co., 22 Fed. 473;

*Farmers Loan & Trust Co. v. Kansas City
Ry.*, 53 Fed. 187.

The cases all show that wherever asserted priorities have been allowed, whether in an administration suit, in a foreclosure suit, or in consequence of orders preliminarily made requiring the payment of specified obligations, the allowance of such priorities in favor of claimants has been based upon the inherent equity of the claim as against the mortgage, rather than on the form or character of the proceeding, or the time in the proceeding at which

the order of preference was made by the court entertaining jurisdiction.

VI.

IF ORIGINALLY THE CIRCUIT COURT LACKED JURISDICTION, THESE APPELLANTS WAIVED ANY DEFENSE BASED ON SUCH LACK OF JURISDICTION BY VOLUNTARILY APPEARING AND SURRENDERING THEMSELVES TO THE JURISDICTION OF THE COURT.

In the preceding subdivision of our argument we have presented cases that show that the lower court possessed full jurisdiction in the matter of the appointment of receiver. There was no lack of jurisdiction. In an administration suit instituted even by an unsecured creditor, as well as in a direct proceeding for foreclosure of mortgage the equities of labor and supply claimants may be considered and adjusted. Certainly on the face of the record presented to this court, whatever is just and equitable as to these labor and supply claimants who kept this railway a going concern until these purchasing appellants came in and took it over at the sale, can be done within the lines of the absolute jurisdiction of the court in this proceeding. The purchasers at the sale, on their own petition, made parties to the proceeding.

In their petition it appeared that:

“Petitioners pray that they may be made parties to the above entitled action and that they be hereby allowed to intervene and appear

herein by their solicitors, and that said petitioners have notice of all proceedings taken herein, that they may take such action herein as may be advised.”

At pages 10, 11, 14, 15, 16, 18, 19, 20 and 21 of the transcript of record herein, it is abundantly shown that these appellants voluntarily became parties to the action; that they appeared by counsel and filed pleadings therein, that they availed themselves of the aid of the Circuit Court, that they appeared before the Master and joined issue with these claimants, and in every possible way made themselves parties to the action. By their conduct they waived any right to object to the jurisdiction of the lower court in the matter of receivership. Their voluntary appearance of itself was a waiver.

In this connection, as sustaining our position, we ask attention to the following cases:

Horn v. Pere Marquette R. Co., 151 Fed. 626;

International Trust Co. v. Townsend Brick Co., 95 Fed. 850;

In re Clarke, 125 Cal. 388;

Olcese v. Justices' Court, 156 Cal. 80;

Zobel v. Zobel, 151 Cal. 98-101;

Security Loan & Trust Co. v. Boston Co., 126 Cal. 418-422;

In re Yoell, 131 Cal. 581.

Appellants having requested action by the Circuit Court, having asked the receiver to join in the sale, having in all matters connected with the sale of the

properties submitted to the jurisdiction and absolute direction of the Circuit Court, having appeared and joined issue with these labor claimants in the proceedings before the Master—are estopped from insisting in this court, or elsewhere, that the lower court was without full jurisdiction to pass on all questions of priority involved in the proceeding before the Master and determined by the decree of the district judge. The position of appellants' counsel in this matter is absolutely without merit.

VII.

THE PERIOD FIXED BY THE AUTHORITIES FOR THE ALLOWANCE OF PRIORITIES AND FOR THE COMPUTATION OF DIVERSION, WHERE DIVERSION IS AN ELEMENT PROPER TO BE CONSIDERED IN ALLOWANCE OF PRIORITIES, IS THE TERM OF SIX MONTHS NEXT PRECEDING THE APPOINTMENT OF RECEIVER.

At pages 73-80 counsel argue the proposition that “no claimant can profit by a diversion unless he shows that a diversion occurred after his indebtedness became payable”. The transcript here shows a diversion during the six months' period of \$30,000.

At page 29 of the transcript the agreed statement shows the following: “The balance of said sum of \$151,000 to wit: \$30,000 was devoted to pay expenses other than those occurring in the normal and ordinary operation of said railroad; that is, for expenses of construction, interest on construction charges, rentals for land used by said company,

and in extinguishment of car trust obligations and constituted what has been commonly called, a diversion of current income of Ocean Shore Railway Company, earned by it during the period from June 1, 1909, to December 6, 1909, to the extent of that amount.”

We have claimed in a preceding subdivision of our argument, and are quite confident in our claim, that it is not incumbent upon claimants, in order to establish priority against these appellants, to establish any diversion, whatever.

Cases generally on this subject, as we read them, are to the effect that if diversion occurs during the six months' period, such diversion must be made good in order to satisfy priorities accruing during the same period. Diversion and priority alike are confined to the identical period.

It cannot be the law that each claimant whose right of priority accrues during such six months' period must show that diversion occurred before the absolute instant of time at which his claim accrued. In attempting to apply the rule suggested by counsel, the court would be obliged to find the amount of diversion, not merely for each particular month, but for each day and hour. Complex as the matter of ascertaining the diversion for the entire period admittedly is, the one sought to be imposed upon the court by counsel is far more complex and impossible of execution. The proposition is, in truth, wholly impracticable, as may be seen

upon a moment's consideration, and this alone is sufficient to show its untenableness, for, to have a rule of law which is impossible of application involves a contradiction of terms.

It is too plain for argument that some fixed period of time must be taken as the basis of any computation of this kind, and the courts with substantial unanimity have fixed this period as the six months next preceding the appointment of receiver.

Appellants' counsel cite in support of their contention, the case of *St. Louis etc. R. Co. v. Cleveland R. Co.*, 125 U. S. 658, at page 74. That is the only United States Supreme Court decision cited by them. The claimant in that case was the St. Louis, Acton & Terra Haute Railroad Company. It presented two claims aggregating \$800,000, one for \$664,874.70 and the other for \$91,860.05. In 1867, the claimant leased its railroad to the mortgagor, the Indianapolis and St. Louis Railroad Co., the lessee agreeing to pay as rent a percentage of its gross earnings, and, in any event, not less than \$450,000 a year. The rent was paid for a period of about eleven years,—that is, until April 1, 1878. In October of the same year suit to recover the money then due was commenced. Later, it seems from the report, foreclosure proceedings were instituted, which resulted in a decree of foreclosure and sale made May 22, 1882. In its endeavor to prove a diversion, the claimant attempted to go back over four years, viz.: to the period before 1878 (when

the default in payment of rent first occurred), during which period the operation claims were all paid. If in the present case the claimants had attempted to prove a diversion which took place prior to the six months' period, (the period of the accrual of the claims now under consideration), the case cited would be applicable.

In the course of the opinion, to show how little bearing the case cited should have on the question now before the court, we ask attention to the following language in the opinion of Mr. Justice Matthews (31 L. Ed. 838):

“It cannot be said that the application of earnings to the payment of interest on the first mortgage bonds is chargeable to the holders of the second and third mortgage bonds. *The latter alone are interested in the fund for distribution.* That fund, in the sense of the rule sought to be applied, cannot be said to have been benefited by the payment to their bondholders from the gross earnings applicable to the payment of the rent. The equity of the petitioner, if in fact it exists, is against the holders of the first mortgage bonds, who have actually received the money to which it claims to be equitably entitled.”

In *Central Trust Co. v. East Tennessee etc. R. Co.*, 80 Fed. 624, the intervenors' claims accrued some time before the beginning of the six months' period, while the claimed diversion upon which they relied occurred prior even to that time. The claimants had theretofore failed to bring themselves within the rule which limits the court in these mat-

ters to a consideration of claims which accrued during the six months' period and to a diversion which accrued during the same period or during the receivership.

In the two cases decided by Judge Philips of the eighth circuit, and reported in 108 Fed. 702 and 145 Fed. 544, substantially the same sort of a situation was presented. In the first, the Master had reported generally as to a diversion which had taken place during a period of almost two years prior to the appointment of the receiver. This was held improper for the reasons stated in the opinion. In the other, there had been no diversion during the six months' period and both the master and the court so found. Failing that, some of the claimants attempted to go back of the period and establish a diversion in that way. This, it was held, they could not do.

We think the answer to this contention of appellants' counsel is well made by the Master at pages 36-38 of his report which we here quote.

"THE QUESTION AS TO TIME OF DIVERSION.

"It is contended by counsel for the purchasers that as to each claim it must be shown as a necessary condition for the allowance of priority that a diversion of current income occurred after claimant's debt became payable. They maintain that the railroad was at no time under any obligation to accumulate a surplus to meet any future debt, and might

spend such surplus as it saw fit, in payment of interest or otherwise, for the benefit of the bondholders.

“If this point is well taken it will decide this reference adversely to all claimants excepting those allowed payment in full under the orders of the court because of the necessities of the receivership. This must result since no proof has been offered as to the time when any particular item of diversion took place.

“Counsel cite in behalf of this view the following cases:

St. Louis & C. R. R. Co. v. Cleveland R. Co.,
125 U. S. 658;

Central Trust Co. v. East Tennessee R. Co.,
80 Fed. 624;

Kansas L. & T. Co. v. Electric &c. R. Co.,
108 Fed. 702;

Fordyce v. Omaha &c. R. Co., 145 Fed. 544,
555.

“In the case in the United States reports the court, for example, said:

“The petitioner, therefore, has no right to complain of any appropriation of the earnings of the leased line during the period in which it received the full amount due to it.’

“In the case in the 108th Federal Reporter the court said:

“The creditor can only concern himself about diversion of current earnings after the creation of his debt.’

“In each of these cases it is to be pointed out the matter came up on a single intervention, where, it would seem, the principle could properly be applied. In each of them, also, the claimant attempted to go back into a prior period to the ‘current period’, whether six months or longer as to the court might seem proper, and establish a diversion during the prior period. The cases would be entirely in point if in the case at bar no diversion were proved during the period taken as the current period, namely, the six months’ interval before the receivership, and the claimant offered proof of a diversion of funds occurring in the year 1908. No case has been cited where the test contended for was applied with regard to diversions during the period within which preferences are recognized. It must, of course, be acknowledged that some of the language of the cases cited would apply to the end contended for, but here, as generally, the court must be understood as speaking with reference to the facts of the case then at bar.

“I am unable to accept any such limitation. It is obvious that the rule contended for is impossible of application in any proceeding where there are a number of claims. A balance would have to be struck at the end of each day during the six months’ period, settling claims due on that day and diversions occurring thereafter, and taking into account restoration of diversion by borrowed money, etc. It is safe to say that such an inquiry would be impossible, and the law adopts no rule which cannot be applied by the use of the ordinary human

faculties. Where transactions are current, consisting of items received and paid, and accounts receivable created and obligations incurred from day to day, it is imperative that the whole period must be taken as a unit and the sums of various items considered as single items without regard to time of accrual within that period. If anything additional need be said it may be pointed out that under the rule maintained by respondents the claims accruing latest, and therefore least open to any defense of laches, would naturally stand much less chance of prior payment than those earlier in the period who would have a greater chance to reach diverted funds.' ”

Summary.

In the preceding pages we feel that we have presented to this court substantial reasons why the action of Judge Van Fleet in this matter should be affirmed. *Every claim represented by us is distinctly a labor claim.* In discussing the opinion of the Master, with which he disagreed as to the priority due to labor claims in the absence of diversion, Judge Van Fleet said:

“And unfortunately for that view, the courts have not given it practical application. *They have, in fact, in every instance thus far occurring where the question has come up, allowed for one reason or another, priority to laborers' claims that have been incurred for the essential purpose of keeping the road in operation; it appears that in this circuit, that principle has in several cases been distinctly announced and affirmed by the Circuit Court of Appeals.*”

If these labor claims are denied priority, irrespective of diversion, it will be the first instance of the kind in the history of this class of litigation.

While the claims urged by us are not very large in amount, they involve a large principle. They represent months of toil performed by our clients—toil which was absolutely *indispensable to the business* of the Ocean Shore Railway as a *going concern*. Without the living energy and direction of these labor claimants, no business would have been transacted during the six months period by the railway; no wheel would have been turned in safety, or at all, nor could a passenger nor a pound of freight have been transported by the railway company in the discharge of its public duty of common carriage imposed upon it by the essential law of its being. The brain and brawn, the blood and bone of these labor claimants were infused into the very vitals of this moribund railway and preserved its life, thus avoiding its otherwise inevitable impending death with a monument erected to its memory in the shape of a scrap-heap composed of its unused and unusable plant and equipment.

The equitable principles involved have been developed during the last 40 years largely by the Supreme Court of the United States in dealing with the vast railway systems of the country, many of which at one time or another have passed through a period of judicial administration. The

argument made by us establishes in our judgment, the following propositions:

1. Current earnings of a railroad company constitute a trust fund to be administered primarily in the discharge of current obligations of ordinary operation.

2. If such funds be diverted from such function, they must be replaced at the expense of the railway property or its proceeds, on a sale thereof.

3. Labor claimants, whose services are *indispensable to the business of the railway in the discharge of its obligations to the public as a going concern*, are not required to show diversion. They may have recourse to the *corpus* of the property, irrespective of diversion.

4. The equities of these claimants may be asserted in the present action without regard to the character of the action in which they are asserted or the person by whom the litigation was initiated.

5. If originally there were any lack of jurisdiction of the Circuit Court for the appointment of receiver, all defenses available to these appellants on the score of such supposed lack of jurisdiction, were absolutely waived by the formal surrender of these appellants to the jurisdiction of the Circuit Court, and their becoming parties to the litigation and seeking the aid of the court for the enforcement and protection of their mortgage rights. The *going concern* theory of the law is still the law as recognized by the Supreme Court of the United States.

The Gregg case does not overrule the Miltenberger case, nor the case of *Union Trust v. Illinois Midland Railway Company*. Those cases still declare the law that a day to day laborer, performing services indispensable to the business of the company and for the purpose of keeping the railway a going concern, whose services are rendered within six months prior to the appointment of receiver, may independently of the question of diversion, insist even as against the mortgage bondholders that they have an equitable claim upon the *corpus* of the property even after a sale.

6. As said by Judge Van Fleet, the law has repeatedly and consistently been declared heretofore in this circuit,—that law demands the affirmance of Judge Van Fleet's ruling.

The action of the District Court should be affirmed.

Dated, San Francisco,
March 7, 1914.

Respectfully submitted,
SULLIVAN & SULLIVAN AND
THEO. J. ROCHE,
*Attorneys for certain labor claimants,
Appellees.*

Addendum—"Going Concern" Cases.

The writer of the foregoing argument, the only member of his law firm familiar with the history of the case and with the arguments made before the Master and Judge Van Fleet, was ill and away from his office from the time appellants' brief was served until the very day before the expiration of the time to serve and file reply thereto—March 6th. The matter shown in the preceding pages was hurriedly assembled, in order that the printed argument might be in the hands of appellants' counsel by the afternoon of Saturday, March 7th. In the attendant haste, there was inadvertently omitted from the brief a reference to the cases heretofore cited by counsel for appellees, which, in the opinion of the writer, sustain the so-called "going concern" theory for the allowance of priorities against the lien of mortgage bondholders, especially the cases decided in this Ninth Circuit, alluded to by Judge Van Fleet in his opinion without specific mention, and discussed in detail in the opinion of the Master at pages 78-81. We give first the Ninth Circuit cases, followed by cases from the Supreme Court and from the other Circuits.

San Francisco, March 9, 1914.

J. F. S.

“Going Concern” Cases—Ninth Circuit.

New York Guaranty Co. v. Tacoma Ry., 83
Fed. 365 (C. C. A. Opinion by Morrow,
Circuit Judge);

Atlantic Trust Co. v. Woodbridge Co., 79
Fed. 39-41 (Circuit Ct. N. D. Cal., Mc-
Kenna, Circuit Judge);

Atlantic Trust Co. v. Woodbridge Co., 86
Fed. 975 (Before Morrow, Circuit Judge
on final hearing).

**"Going Concern" Cases From U. S. Supreme Court
And Other Circuits.**

- Miltenberger v. Logansport Ry. Co.*, 106
U. S. 287;
- Union Trust Co. v. Illinois Midland Ry.*, 117
U. S. 434;
- Burnham v. Bowen*, 111 U. S. 776; 28 L. Ed.
596;
- Blair v. St. Louis Ry.*, 22 Fed. 474;
- Finance Co. v. Charleston Ry.*, 48 Fed. 189;
- Virginia & Ala. Coal Co. v. Central R. Co.*,
170 U. S. 355-372; 42 L. Ed. 1068;
- Central Trust Co. v. East Tennessee Co.*,
80 Fed. 624 (C. C. A., 6th Circuit);
- Southern Ry. v. Carnegie Steel Co.*, 76 Fed.
492 (C. C. A., 4th Circuit);
- Lackawanna Iron & Coal Co. v. Farmers'
Loan & Trust Co.*, 79 Fed. 202 (C. C. A.,
5th Circuit);
- Southern Ry. Co. v. Carnegie Steel Co.*, 176
U. S. 257-297; 44 L. Ed. 458-471;
- Virginia Passenger & Car Co. v. Lane Bros.
Co.*, 174 Fed. 516 (C. C. A., 4th Circuit,
decided since the Gregg case, Dec. 5th,
1909);
- Finance Co. v. Charleston R. Co.*, 62 Fed.
205, 208 (C. C. A., 4th Cir. Fuller, C. J.);
- Southern Ry. v. Ensign Mfg. Co.*, 117 Fed.
417, 419-20 (C. C. A., 4th Circuit).

IN THE
United States Circuit Court of Appeals
FOR THE
NINTH CIRCUIT

CHARLES C. MOORE, ET AL.,
Intervenors and Appellants.

vs.

F. L. DONAHOO, ET AL.,
Appellees.

No. 2353.

BRIEF FOR CERTAIN SUPPLY AND LABOR
CLAIMANTS.

The following brief is presented on behalf of various supply and labor claimants of the Ocean Shore Railway Company, whose claims were established as preferential by the decree appealed from. The record shows that the materials and services covered by these claims were in every instance "necessary to the *business* of the Ocean Shore Railway Company as a carrier of freight and passengers, and to the public service," and were "required to keep it a going concern." (Tr., p. 27.) All were incurred within six months before the appointment of the receiver and all "constituted current and ordinary debts of the Company incurred in its normal operation." (Tr., p. 25.)

At the hearing before the Master, we relied upon the following propositions:

(1) That these claims (which are strictly limited to claims for supplies and services necessary to the *business* of the road, as distinguished from construction and maintenance or "preservation" claims) were entitled to be established as preferential, in the absence of any diversion.

(2) That the diversion amounted to \$80,000. Exceptions were taken by us to the finding in the Master's report that the diversion amounted only to \$30,000, and also to the finding that the claims in question could be considered as preferential only to the extent of the diversion proved. The last mentioned exception was sustained by the court; in other respects, the report was confirmed. Since the claimants have not appealed from the decree, the question whether the amount of diversion was correctly found by the Master is not presented for review upon this appeal, and will therefore not be discussed in this brief.

I. THE MATERIALS AND SERVICES COVERED BY THE CLAIMS IN QUESTION, ALL OF WHICH THE RECORD ESTABLISHES WERE ABSOLUTELY NECESSARY TO THE BUSINESS OF THE ROAD, MAY BE ALLOWED PREFERENCE OVER THE MORTGAGE INDEBTEDNESS IN THE ABSENCE OF ANY DIVERSION.

At the outset of the discussion, it seems essential to notice some of the more important circumstances which enter into the determination of the question of the relative value and worth of the conflicting equities of the operation and maintenance creditors, on the one hand, and the bondholders, on the other. It will be seen that

these equities are by no means fixed and inelastic, but that, in accordance with the general principles of equity, their relative value and character vary with the particular circumstances surrounding each claim. Keeping this principle in mind, we think most of the cases upon the general subject, (including many of those which discuss the question whether proof of diversion is necessary, and which, upon first consideration, may be thought to be sharply in conflict) may be reconciled.

It is essential, first of all, that the peculiar nature of the property involved, upon which the bondholders assert a lien, be kept in mind. In almost every branch of the law such property is held to be subject to rules which are not applied to other property. Thus, generally speaking, ejectionment cannot be maintained against a railroad to recover a right of way used by it. (*Fresno, etc. Co. v. Southern Pacific Co.*, 135 Cal. 202.) Neither can one obtain a title by adverse possession to such property (*Southern Pacific Co. v. Hyatt*, 132 Cal. 240), nor can the company's rolling stock or other property necessary to the operation of the road be subjected to attachment. In line with these decisions, it is held that the rights of mortgage creditors of a railroad are different in some respects from those of ordinary mortgage creditors; and, as a consequence we may expect to find, and do find, that in legal proceedings involving railroad mortgages, principles are properly applied which are not met with in other cases. It need hardly be said that to apply these principles is not to rob the mortgagee of any of his rights, as has often been asserted, but merely

to enforce those actually obtained by him under his contract, which he is presumed to have entered into with full knowledge of the peculiar nature of his security and of the law applicable thereto.

As said by Judge Simonton in *Bound v. South Carolina, etc. Ry. Co.*, 50 Fed. 312, 314:

"All the cases go upon the ground that a railroad is a peculiar property of a public nature, discharging a great public work. No railroad designed for any public benefit can be built without the active interposition and assistance of the sovereign power. It is necessary not only to furnish the money to construct it; it is more essential to secure the land upon which it is to be constructed. This requires the exercise of the right of eminent domain. Without it, money would be powerless. Railroads connect distant points. That they are common carriers is but a small part of their office. They are not only the arteries of trade; they civilize, develop, and enrich large sections of country; cities, towns and villages, farms and factories, spring up on their line; they make intercommunication of vital importance to thousands; they are the means of transporting troops, munitions of war, and supplies, promoting and preserving tranquility in times of peace, connecting and creating strategic points in times of war; they are public highways. Public interest, the highest public interest, requires that when constructed they be kept up; be kept, as the phrase is, a "going concern." The cost of building and maintaining them is enormous. Their earnings are fluctuating. The states and national government so far have not been able to build railroads required by the necessities of our country. Subscriptions to the stock in a very few cases furnish money enough to build them. Capitalists are invited to assist in investing in the railroad bonds. So, in order to construct a railroad two parties must concur,—the stockholders and capitalists, who put in the money and the work; the sovereign power, which contributes the

right of eminent domain. Without the money and without this sovereign right, the road cannot be built. *The consideration which moves the sovereign to bestow this high sovereign prerogative—the right of eminent domain—is the public use of the railroad, when built; that it remain of use, that it be and remain a going concern. To this end the first application of its earnings must be made. The stockholder subscribes, and the bondholder lends his money, with knowledge of this. Neither of them can get anything until the current expenses are paid.*”

In the case of *International Trust Co. v. Decker Bros.*, 152 Fed. 82, this Court expresses itself in a similar vein, saying, through District Judge Wolverton:

“The reasons for the authority are peculiar to railroad corporations, and to the enterprise in which they engage, the most salient of which are that railroads are quasi public concerns, through which the public interests and convenience, as well as private ownership, are largely subserved, and that a maintenance of the roadway and equipment, and a continuation of the business and operation of the road, are essential to the preservation of the mortgage property. *Any person or corporation, in taking and accepting a mortgage upon the property of a railroad, therefore, does so with reference to the law governing such corporations, and with knowledge, presumably, of the legal condition that, for the purpose of keeping the enterprise a going concern, receivers may be appointed and receiver’s certificates issued in appropriate cases, which, in their force and effect, will supplant the mortgage, and hence with the understanding that the mortgage lien may be superseded by the necessary expenses for continuing the business and thereby preserving the security of the mortgage.*”

In *Virginia Passenger, etc. Co. v. Lane Bros. Co.*, 174 Fed. 513, a recent case, decided December 15, 1909, the

Circuit Court of Appeals for the Fourth Circuit, after a review of the authorities, including the Gregg case, said (p. 516):

“One of the foundations of the principle is that the public interest requires that a railroad must be kept a ‘going concern.’ It does not depend, therefore, upon the diversion, or even upon the existence of income.”

One who invests his money upon the security of this kind of property, therefore, does so knowing that by reason of the interest possessed by the public, the rights obtained by him are less extensive than they would be if his security was of a different character. To offset this disadvantage, the investment offers many counter attractions, which flow from the peculiar and immensely valuable privileges conferred by law upon railroads.

See, also, in this connection:

Fosdick v. Schall, 99 U. S. 235;

Wood v. Guarantee Trust Co., 128 U. S. 416;

Seventh National Bank v. Shenandoah etc. Co.,
35 Fed. 439;

Bernard v. Union Trust Co., (C. C. A., 4th Cir.)
159 Fed. 622;

In re Clark Coal Co., (Dist. Court W. D. Pa.)
173 Fed. 663.

Resort to the principle of “public interest,” however, is perhaps not necessary, strictly speaking, in every case in which priority is given to certain creditors over mortgage creditors. It is never necessary, for example, when there has been a diversion of the “current debt

fund" to the benefit of the mortgage creditors. This, for the reason that under all of the decisions, mortgage creditors have no lien upon income, even though it be in terms mortgaged, until such time as they have caused it to be sequestered by the appointment of a receiver, or otherwise, (*Central Trust Co. v. Mobile Ry. Co.*, 173 Fed. 330; *Berwind-White, etc. Co. v. Metropolitan, etc. Co.*, 183 Fed. 250, 254; *Daw v. Memphis Ry. Co.*, 124 U. S. 654; *New England Railway Co. v. Carnegie Steel Co.*, 75 Fed. 56), and that they obtain no superior or additional rights therein by the circumstance that such income has been converted into property of a different kind. In cases where there has been a diversion, therefore, it is a matter of right that the mortgagee should give up what has been improperly added to his security, and he may be compelled so to do upon familiar principles of equity and apart from the consideration above referred to growing out of the peculiar nature of the property in which he has invested his money, and which (to use Judge Waite's language in *Munn v. Illinois*), has "become clothed with a public interest."

In addition to the foregoing, other considerations have been held to justify the establishment of the priority of claims possessing peculiar merit in the eyes of a court of equity, over those of mortgagees. As said by Judge Simonton in *Southern Ry. Co. v. Ensign Ry. Co.*, 117 Fed. 420, delivering the opinion of the Circuit Court of Appeals for the Fourth Circuit, "No hard and fast rule has been adopted. Each case depends upon its own circumstances."

Thus, delay on the part of the mortgagee in taking possession of the road, has often been spoken of by the courts as justifying the allowance out of the corpus of certain claims which have accrued during such delay.

Dow v. Memphis, etc., Ry. Co., 20 Fed. 267;

Union Trust Co. v. Southern, 107 U. S. 571;

Duncan v. Trustees, 9 Am. Ry. Rep. 386;

Williamson's Admr. v. Washington, etc., Ry. Co., 33 Gratt. 624;

Douglas v. Kline, 12 Bush (Ky.) 608;

Farmers Loan Co. v. Green Bay R. Co., 45 Fed. 664, in which it is said (p. 665) :

“The exercise of this equitable power in the Court is not, however, dependent solely upon diversion of current earnings to payment of bond interest leaving current expenses unpaid, but is exercised as well in consideration of the fact that, in case of failure of the trustee to take possession upon default, it is indispensable to the preservation of the property, and its maintenance and integrity that it should be operated.”

Moreover, the fact that the mortgagee has either himself invoked the jurisdiction of the court or, (as in the case at bar) after the commencement of the proceedings, has obtained relief therein in enforcing its security has been held to justify the payment of certain preferred claims out of the corpus.

Fosdick v. Schall, 99 U. S. 235, 253;

Dow v. Memphis, etc., Ry. Co., 20 Fed. 267;

Calhoun v. St. Louis, etc., Co., 14 Fed. 10;

Southern Railway Co. v. Carnegie Steel Co., 76 Fed. 492, 20 Sup. Ct. 347.

The most important equity, however, which is involved in cases of this kind is that growing out of the *nature of the claim itself as regards its relation to the business of the railroad* and the time of its accrual. With respect to operation claims which accrued shortly before the appointment of the receiver, where the services or materials covered thereby were essential to the *business* of the road, as distinguished from those necessary only to its maintenance or preservation, the decisions, as we shall shortly endeavor to show, establish that priority may be allowed in the absence of diversion. Such claims are looked upon with peculiar favor by courts of equity. "The nature and reason of this equity," said the Court in *Bound v. South Carolina, etc. Ry. Co.*, 47 Fed. 31, "are found in the fact that a going railroad is of public concern and must be kept up. *Those who contribute to keep it up and so subserve the public weal are rewarded.*" In *Finance Co. v. Charleston, etc., Ry. Co.*, 48 Fed. 189, the same idea was expressed, the Court saying:

"Those who contribute to keep a railroad a going concern frequently continue their contributions when ordinary enterprises would lose all credit. *They deserve and receive all the assistance the Courts can give them without violating the essential right of property.*"

We pass, now, to a consideration of the authorities bearing upon the necessity of proof of diversion in cases where operation claims of the kind referred to are involved.

In this circuit the cases are uniform that proof of diversion is not essential.

In *New York Guaranty, etc., Co. v. Tacoma Ry. Co.*, 83 Fed. 365, the Circuit Court for the western division of the District of Washington had allowed preference to the claim of Broderick and Bascom Rope Co. for \$620.45, being the price of a cable rope sold and delivered to the mortgagor over two years before the appointment of the receiver. Upon appeal to the Circuit Court of Appeals for the Ninth Circuit, it was held that the claim was properly given priority over that of the mortgagee, the Court declaring that the cable was necessary to the operation of the road (p. 368) and that proof of delivery was unnecessary (p. 369). In the course of his opinion, Judge Morrow, who delivered the opinion of the Court, quoted with approval the following language of Judge Caldwell in *Farmers Loan and Trust Co. v. Kansas City, etc., R. Co.*, 53 Fed. 189:

“It is an error to suppose that such debts can only be given priority where there has been a diversion of the income of the road. Nor is it true that they can only be paid out of the earnings of the road, and cannot be made a charge on the corpus of the property. A diversion of the income is not essential to give them priority, and they may be made a charge on the corpus of the estate if the earnings are not sufficient to pay them.’—citing *Miltenberger v. Railway Co.*, 106 U. S. 286-311, 312, 1 Sup. Ct. 140; *Union Trust Co. v. Illinois M. Ry. Co.*, 117 U. S. 434-457, 6 Sup. Ct. 809; *Thomas v. Railway Co.*, 36 Fed. 808.”

In the case of *Atlantic Trust Co. v. Woodbridge, etc., Co.*, 79 Fed. 39, 41, Judge McKenna, delivering the opinion of the Circuit Court of Appeals for this circuit, said that it was "clear that diversion of income is not a universal condition of preference."

The rule in the fourth circuit is established by the cases of *Finance Co. v. Charleston R. Co.*, 62 Fed. 205, 208 (opinion by Chief Justice Fuller); *Southern Ry. Co. v. Ensign Mfg. Co.*, 117 Fed. 417, and *Virginia Passenger, etc., Co. v. Lane Bros. Co.*, 174 Fed. 513, the latter a very recent decision in which the *Gregg case* and decisions of the Supreme Court which preceded it are reviewed. In all of these cases, it was held that proof of diversion was unnecessary where the claim sought to be established as preferred accrued in the operation of the road.

It will be necessary to consider only the *Lane Bros. Case* cited above, for that is the last case on the subject decided in the fourth circuit. It is besides one of the most recently reported cases decided in any of the federal courts upon the proposition under discussion, and for that reason it is of particular interest and value as showing the interpretation placed by the court upon the decisions of the Supreme Court.

Lane Bros. Co., the intervening creditors, had performed work during the month preceding the appointment of the receiver in widening and deepening a canal with a view of producing power by water instead of by steam at what was known as the Petersburg plant of the mortgagor. This plant was at that time a very old one,

equipped with old machinery, the "reliable life" of which, to use Judge Brawley's expression, was passed. The Master reported that the work "was essentially necessary to enable the Virginia Passenger & Power Company to operate its railway lines as a continuing business; that the latter company would have failed in its duty (a) to the public, (b) its mortgagees, and (c) its stockholders, if it had neglected to make the improvements contemplated in its contract of August 15, 1903, with Lane Bros. Company."

The evidence further showed that the funds received from the current earnings of the mortgagor and funds derived from all other sources were all put together and payments were made out of this fund. Upon the books of the company the work done by the intervenor was charged to construction. Apparently no diversion was established.

The following is quoted from the opinion of the Court affirming the judgment of the Circuit Court allowing the claim as a preferred one:

"The courts have laid down no inflexible rule that governs in all cases, but, beginning with *Fosdick v. Schall*, 99 U. S. 235, 25 L. Ed. 339, the Supreme Court has in numerous cases stated the governing principle. Many of these cases are reviewed in *Southern Railway v. Carnegie Steel Company*, 176 U. S. 257, 20 Sup. Ct. 347, 44 L. Ed. 458, and *Gregg v. Met. Trust Co.*, 197 U. S. 183, 25 Sup. Ct. 415, 49 L. Ed. 717, is one of the last that has been brought to our attention. The principle seems to be this: That every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any

claim on the income; that the income out of which he is entitled to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvements. In a certain limited class of cases such preferential payments have been allowed out of the corpus, but these cases need not be considered, as here the income from current receipts is more than ample for the payment of this claim. *One of the foundations of the principle is that the public interest requires that a railroad must be kept a 'going concern.' It does not depend, therefore, upon the diversion, or even upon the existence of income.*" . . .

"As a matter of bookkeeping, payments made on this account were charged to construction account, and appellants contend that work for new construction does not fall within the principle above stated, that preferential payments are allowed on account of operating expenses, citing *Hale v. Frost*, 99 U. S. 389, 25 L. Ed. 419. That case was decided at the same term with *Fosdick v. Schall*; the Chief Justice, who delivered the opinion in the leading case, announcing in a short opinion that it is governed by *Fosdick v. Schall*. Hale & Co. had two accounts, one for supplies for the machinery department, and one for material for construction purposes. As to the first, preferential payment was allowed; as to the second, the Court says:

"There is nothing in the case to show any special equities in their favor in respect to that part of their account which is for material for construction purposes."

"The precise nature of this account is not stated in the report of the case. It may have been proper for the company, as a matter of bookkeeping, to charge this improvement to construction account, but it is plain that the indebtedness incurred was for the permanent improvement of the mortgaged property. *It was not a new construction in the sense that the building of a new railroad, or the building of a new plant, would be, but*

was, as said by the judge below, 'something necessary in furtherance of the more effective and economical operation of the existing plant.'"

The opinion concludes as follows:

"The testimony shows that the payments made to Lane Bros. Company up to the time of the appointment of the receivers were made as ordinary operating expenses, and there are no circumstances tending to show that the intervening petitioners relied upon the general credit of the Virginia Passenger & Power Company, or took any other security, or had any other expectation than that they were to be paid out of the current receipts. The judgment of the court below is affirmed."

In *Cleveland, etc., Co. v. Knickerbocker Trust Co.*, (Cir. Ct. N. D. Ohio E. D.) 86 Fed. 73, 77, it was said:

"It being determined that this work was necessary to keep the property a going concern, we are to decide whether lack of proof of diversion, and the fact that more than six months expired between completion and the appointment of receivers, precludes recovery. I think not."

(Citing, among other cases, *Miltenberger Case*, 106 U. S.; *Union Trust Co. v. Ill. Ry. Co.*, 117 U. S. 434; *Burnham v. Bowen*, 111 U. S. 776; *Trust Co. v. Morrison*, 125 U. S. 591.)

In *Wood v. New York, etc., Ry. Co.*, (Cir. Ct. D. Mass.) 70 Fed. 741, it was said per Circuit Judge Colt, that, "independently of the question of diversion, debts may be preferred which are incurred for labor and supplies necessary to keep the road a going concern from day to day, or which are the outcome of indispensable

business relations, a continuance of which involves the interests of the public and the traffic of the road," (citing a number of cases decided by the Supreme Court).

In *Farmers Loan, etc., Co. v. Kansas City, etc., Co.*, 53 Fed. 189, Circuit Judge Caldwell said:

"As it is an error to suppose that such debts can only be given priority where there has been a diversion of the income of the road; nor is it true that they can only be paid out of the earnings of the road, and cannot be made a charge upon the corpus of the property. A diversion of the income is not essential to give priority, and they may be made a charge upon the corpus of the estate if the earnings are not sufficient to pay them. *Miltenberger v. Railway Co.*, 106 U. S. 286, 311, 312; 1 Sup. Ct. Rep. 140; *Union Trust Co. v. Illinois M. Ry. Co.*, 117 U. S. 434, 457, 463, 6 Sup. Ct. Rep. 809; *Thomas v. Railway Co.*, 36 Fed. Rep. 808. Nor is it essential that the order for the payment of preferential debts should be made at the time, and as a condition, of appointing a receiver. The better practice is to do so, but if such an order is not then made, it may be made afterwards. *Central Trust Co. v. St. Louis A. & T. Ry. Co.*, 41 Fed. Rep. 551; *Fosdick v. Schall*, *supra*; *Blair v. Railroad Co.*, 22 Fed. Rep. 471. It is not to be implied from what is here said that a mortgagee of a railroad can escape payment of preferential debts by the foreclosure of his mortgage without asking for a receiver. Liabilities of a railroad company which fall within the definition of preferential debts have priority over a mortgage on its road, without regard to the question of receivership."

In *Central Trust Company v. Wabash, etc., Ry. Co.*, 30 Fed. 332, as pointed out in *Farmers Loan Co. v. Kansas City, etc., Co.*, 53 Fed. 187, Judge Brewer allowed \$3,000,000 preferential debts in a case in which the original bill was filed by the mortgagor.

In *Blair v. St. Louis, etc., Ry. Co.*, 22 Fed. 475, the same Judge said:

“It is true from the quotation just made (Miltenberger) from the Supreme Court that cases may arise in which such claims will be made a lien upon the corpus of the property and payable out of the proceeds of receiver’s certificates. But this can only be done in exceptional cases and where there is special equity therefor.”

Alderson on Receivers (p. 444), the author thus states the rule:

“It is not necessary to show a diversion of the income in order to entitle claims to be paid out of the income prior and in preference to the mortgage indebtedness. If the thing for which payment is claimed was necessary to continue the operation of the road, it is entitled to payment before the mortgage indebtedness, whether there was a diversion of income or not.”

In *Short on Railroad Bonds and Mortgages*, p. 604, it is said:

“To what extent those claims shall be postponed, whether as regards the income only or the corpus, is a question which as said in *Miltenberger v. Logansport Ry.*, *supra*, must be decided according to the circumstances of the case. If it is a matter of equity and good conscience, the debt will be charged on the income only. If non-payment of the debt endangers the public interests, the court will not hesitate to make the corpus of the estate responsible for the satisfaction of the creditors’ demand.”

In a note found in 83 Am. St. 73, it is said:

“And debts incurred for labor and supplies in the everyday operation and management of the road were

entitled to a preference, independently of the question whether there had been a diversion of the current debts to the benefit of prior lien-holders, either by payment of interest on the mortgage debt, the purchase of property, or the making of permanent improvements. Undoubtedly, this rule had the support of judicial authority, and perhaps the weight of authority still favors a preference to such debts contracted prior to the receivership, independently to the doctrine of diversion."

See, also:

Finance Co. v. Charleston, etc., Co., 62 Fed 205.

Lee v. Pennsylvania Traction Co., (Cir. Ct. E. D. Pa.) 105 Fed. 405;

Farmers Loan & Trust Co. v. Vicksburg, etc., Ry. Co., 33 Fed. 784;

Fordyce v. Omaha, etc., R. Co., (Cir. Ct. W. D. Mo.) 145 Fed. 544, 555.

Guarantee Trust Co. v. Philadelphia Co., 160 Fed. 761;

Drennan & Co. v. Mercantile Trust Co., 39 L. R. A. 627.

These cases, we think, express the interpretation placed upon the decisions of the Supreme Court in the majority of the circuits. In the Sixth and Eighth Circuits, only, different view has been taken. In both of them, the doctrine was first announced that neither the existence of income, nor diversion need be shown (see *Central Trust Co. v. East Tennessee, etc., Co.*, (C. C. A. 6th Cir.) 80 Fed. 628 (Opinion by Lurton, J.), and *St. Louis Trust Co. v. Riley* (C. C. A. 8th Cir.) 70 Fed. 32, 37 (Opinion by Sanborn, J.)). Afterwards both courts, the same judge writing the opinions, announced the op-

posite conclusion. (See *International Trust Co. v. Townsend, etc., Co.* (C. C. A. 6th Cir.) 95 Fed. 858 (Opinion by Lurton, J.), and *Doud v. Illinois Trust, etc., Co.*, (C. C. A. 8th Cir.) 105 Fed. 123 (Opinion by Sanborn, J.). Neither of the last mentioned decisions need receive further attention, for, as we shall presently endeavor to show, they are both in effect limited or overruled by the decision of the Supreme Court in the *Gregg Case* reported in 195 U. S.

We pass, now, to a consideration of the decisions of the Supreme Court upon the subject.

Miltenberger v. Logansport Ry. Co., 106 U. S. 286, is a leading case and has been cited as controlling authority in almost every later case on the subject decided by the Supreme Court. It was directly held therein that the equities surrounding certain classes of claims which accrued prior to the receivership may be so potent as to warrant their payment out of the corpus, in the absence of proof of diversion. The claim involved was one for ticket and freight accounts and balances due connecting lines, and which had accrued more than three months before the appointment of the receiver. The claim was held to be properly payable out of the corpus without proof of diversion.

The Circuit Court, by an order dated August 26, 1874, had allowed the claim upon a petition stating that the payment of that class of claims "was indispensable to the *business* of the road" (106 U. S. 311). Apparently it was not paid at that time, but allowance for its payment out of the corpus, as well as the payment there-

from of a number of other claims of different kinds, was made in the decree directing a sale (X312).

The action of the lower court was approved by the unanimous judgment of the Supreme Court. After disposing of the contention (not uncommon in these cases) that because the receiver had been appointed at the instance of one class of creditors, other creditors should receive advantages and privileges that they would not otherwise have been entitled to, the Court said, per Mr. Justice Blatchford (pp. 311, 312) :

“It cannot be affirmed that no items which accrued before the appointment of a receiver can be allowed in any case. Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, *or even the corpus of the property*, under the order of the Court, with a priority of lien. Yet the discretion to do so should be exercised with very great care. The payment of such debts stands, *prima facie*, on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter by special circumstances. It is easy to see that the payment of unpaid debts for operating expenses, accrued within ninety days, due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from work simultaneously is to be deprecated, in the interests both of the property and of the public, and the payment of limited amounts due to other and connecting lines of road for materials and repairs and for unpaid ticket and freight balances, the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, the

general consequence involving largely, also, the interests and accommodation of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense, by maintaining the good-will and integrity of the enterprise, and entitle them to be made a first lien." . . . "*The appellants furnish no basis for questioning any specific amounts allowed in respect of the arrears referred to, but object to the allowance of anything out of the sale of the corpus for such expenditures. Under all the circumstances of this case, we see no valid objection to the provisions of the orders complained of.*"

In *Union Trust Co. v. Southern*, 107 U. S. 591, the diversion in the period prior to the appointment of the receiver amounted only to \$3000. In the order appointing the receiver the latter was directed to "pay and discharge all amounts due and owing by said railroad company for labor or supplies that may have accrued in the operation of such railroad property within six months immediately preceding the rendition of this decree. The report shows that "when the order in respect to debts for labor and supplies was entered, the court instituted no special inquiries in respect to the use which had been made of the income prior to that time" (p. 592). However, during the receivership there were some net earnings from operation, which were expended in purchasing additional ground, rolling stock, etc. The claim of E. E. Southern and Brothers, the intervening creditors, was for \$532.14 for supplies furnished prior to the receivership.

The Supreme Court (all of the justices concurring) held that the claim was properly allowed preference.

In the course of his opinion, Mr. Chief Justice Waite, who delivered the opinion of the Court, after quoting at length from the case of *Fosdick v. Schall*, 99, A. S. 251, respecting the power of the Court to impose terms upon appointing a receiver, added:

"To this we adhere, and, in our opinion, the right to impose terms does not depend alone on whether current earnings have been used to pay the mortgage debt, principal or interest, instead of current expenses."

(Citing *Miltenberger v. Logansport Railway Co.*, 106 U. S. 286.)

The learned justice then points out that the delay of the mortgagee in seeking the appointment of the receiver, during which time the claim accrued, was an additional reason for allowing the preference claimed.

In *Union Trust Co. v. Illinois Midland Co.*, 117 U. S. 434, the proceeding was brought by a stockholder and certain judgment creditors. The Peoria, Atlanta & Decatur Railroad Co. (whose name was afterwards changed to Illinois Midland Railway Co.) had purchased two other roads, the Paris & Decatur Railroad Co. and the Paris & Terre Haute Railroad Co., and had assumed the payment of all the bonded and floating indebtedness of both of them. The latter were then subject to a large bonded indebtedness. Afterwards, the Midland Co. executed to the Union Trust Co. a mortgage covering all of its properties, including that so purchased, to secure a bond issue of over \$4,000,000.

On September 11, 1875, one Hervey, a large stock-

holder of all of said companies, and certain judgment creditors of the Paris and Decatur Co., filed their bill praying for the appointment of a receiver and the establishment and payment of the various claims and liens upon said properties. The court ordered the payment of all claims due to all operatives and employees and attorneys and agents of said company or companies for any service rendered said company or companies during the six months prior to the appointment of the receiver. It also ordered paid certain supply claims and certain claims due connecting lines and arising out of the interchange of business. Apparently, these claims were not all paid by the receiver under the authority of this order, for by an interlocutory decree entered June 11, 1884, a commissioner therein named was "directed to take an account of all the indebtedness of the receivership, and of all claims of employees which accrued within six months before the first appointment of a receiver, and of all claims for rights of way or lands used for railroad purposes, not paid for, and of all bonded indebtedness of the four corporations, properly classified; and to report as to all contested claims, with the testimony thereon."

One of the points urged upon appeal was that the lower court had erred in allowing priority to the "amount of wages due employees of the Illinois Midland Company within six months immediately preceding the appointment of the receiver" (p. 464). There was no proof of diversion. The Supreme Court held these claims were properly allowed preference over the lien of the bondholders (p. 464).

In the course of its consideration of another contention urged by the appellants, the court pointed out the distinction between railroad and other property, saying (p. 455) :

“A railroad, and its appurtenances, is a peculiar species of property. Not only will its structures deteriorate and decay and perish if not cared for and kept up, but its business and good will will pass away if it is not run and kept in good order. Moreover, a railroad is a matter of public concern. The franchises and rights of the corporation which constructed it were given not merely for private gain to the corporators, but to furnish a public highway.”

Quoting from the opinion in the *Miltenberger Case*, *supra*, the court said (p. 457) :

“It cannot be affirmed that no items which accrued before the appointment of a receiver can be allowed in any case. Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, or even the corpus of the property, under the order of the court, with a priority of lien.”

In *Union Trust Co. v. Morrison*, 125 U. S. 591, a judgment for \$9500 and costs was obtained against the mortgagor railroad, and execution having issued, and the sheriff having threatened to levy upon the rolling stock of the railroad, the company filed its bill in the state court to enjoin the judgment creditor from further proceeding under his judgment. The injunction was granted upon condition that the company should give

an injunction bond with sureties, for the payment of the judgment and costs, in case the injunction should be dissolved. The injunction ultimately was dissolved, and Morrison, the intervenor, who had gone upon the bond as surety at the request of the company, was obliged to pay the amount of the judgment.

The reason given by the receiver for not paying the claim was that the receiver never had receipts in his hands sufficient to have protected him; and the Supreme Court says, through Mr. Justice Bradley, that this assertion seems to have been credited by the intervenor (p. 610). The opinion goes on to show, however, that in all probability net receipts were earned during the receivership and that these had been expended in the purchase of rolling stock, etc. The intervenor having shown that expenditures for this purpose were in fact made, the court holds that the burden of proving the amount thereof rested upon the trustee and receiver (p. 611).

The case is then considered from the standpoint of there having been no net receipts from operation during the receivership, and the view is clearly taken that under that assumption even the claim was entitled to preference by reason of its intrinsic worth, growing out of the circumstance that the intervenor, by going on the bond, had prevented the abstraction and loss of part of the road (p. 612).

The case is of interest and importance as showing that claims of particular merit in the eyes of a court of equity may be allowed preference even in the absence of

diversion. In that case, the creditor had kept the properties together by going on the bond. In the case at bar, the labor claimants on whose behalf this argument is presented, served the road in its hour of greatest need by staying at their posts when, as those who are resisting the allowance of their claims *now* say they should have deserted. But would they have given this counsel either to the company or to the employees when the services in question were being performed? The only answer which can be given is that they would have given no such advice, for it was to the interest of all, and most of all to the mortgagee, that the road should be kept a going concern. In a very real sense, these employees were retained in the employ of the company, and those who furnished supplies to keep it a going concern, furnished them, with the consent and approval of the bondholders. In the language of Mr. Chief Justice Waite in the case of *Burnham v. Bowen*, 111 U. S. 776, 781:

“The debt due Bowen (a supply claimant) was incurred to keep the road running, and thus preserve the security of the bond creditors. *If the trustees had taken possession under the mortgage, they would have been subject to similar expenses to do what the company, with their consent and approbation, was doing for them.*”

In *Virginia Coal Co. v. Central Railroad, etc., Co.*, 170 U. S. 355, 18 Sup. Ct. 657 (where, it is true, there were surplus earnings during the receivership), Mr. Justice White, delivering the opinion of the court,

quoted with approval the following from the *Miltenberger Case* quoted in *Thomas v. Car Co.*, 149 U. S. 110, and *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434:

“Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property for the receiver to pay pre-existing debts of certain classes out of the earnings of the receivership, *or even the corpus of the property*, under order of the Court, with a priority of lien.”

(18 Sup. Ct. 662.) (Italics throughout this brief are our own.)

And again, on page 661, the learned justice, after stating it to be well settled that a claim for coal purchased for use in operating a railroad was “a charge in equity on the continuing income, as well that which may come into the hands of a court after a receiver has been appointed as that before,” said:

“It is immaterial, in such case, in determining the right to be compensated out of the surplus earnings of the receivership, whether or not during the operation of the railroad by the company there had been a diversion of income for the benefit of the mortgage bondholders, either in payment of interest on mortgage bonds or expenditures for permanent improvements upon the property. Nor is the equity of a current supply claimant in subsequent income arising from the operation of a railroad under the direction of the court affected by the fact that while the company is operating its road its income is misappropriated and diverted to purposes which do not inure to the benefit of the mortgage bondholders, and are foreign to the beneficial maintenance, preservation, and improvement of the property. This principal finds support in Miltenberger v. Railroad Co.,

106 U. S. 286, 311, 312, 1 Sup. Ct. 140, the decision in which case was approvingly referred to in *Union Trust Co. v. Illinois M. Ry. Co.*, 117 U. S. 434, 6 Sup. Ct. 809, and in the recent case of *Thomas v. Car Co.*, 149 U. S. 95, 110, 13 Sup. Ct. 824."

In all these cases, the proposition has been laid down that claims of certain defined classes may be allowed preference, even in the absence of diversion. Not once, merely, has the rule been so stated by the Supreme Court of the United States, but in all the decisions above referred to; and these expressions of opinion commencing with the *Miltenberger Case* in 106 U. S., or earlier, and expressly confirmed and approved in case after case since decided, has furnished the basis for the establishment of similar holdings in most of the different circuits. We desire now, to refer briefly to the latest decision of the Supreme Court of the subject—the much discussed *Gregg Case*—which, as we understand it, confirms and places beyond doubt the correctness of the proposition advanced by us and now under discussion.

The case is reported in 109 Fed. 220, 124 Fed. 721, and 195 U. S. (25 Sup. Ct. 415).

In the case in 109 Fed., it appeared that the Master in Chancery had reported that none of the appellants were entitled to preference, solely by reason of the fact that no diversion had been shown. Both the Master and the Circuit Court, however, had erroneously assumed that the payment of car trust obligations out of current income was not a diversion, and had refused to consider such payments as elements of diversion. For this

reason, the decree was reversed by the Circuit Court of Appeals, and the cause was remanded to the Circuit Court, "with directions to reopen the Master's report upon the question of diversion of income, and refer the same, with leave to both parties to take additional evidence" (109 Fed. 230).

The report of the second appeal (124 Fed. 721) shows that after taking further evidence with respect to the subject of diversion, the Master again reported that there had been no diversion. The claimants again excepted to the Master's report, and the Circuit Court again overruled the exceptions and entered decrees denying the claimed preference. The basis of this decision was that the diversion shown had been replaced by borrowed money.

A writ of certiorari to the Circuit Court of Appeals having been allowed, the claim of Gregg came before the United States Supreme Court (195 U. S.; 25 Sup. Ct. 415). Both the opinions rendered by the majority and by the minority of the court distinctly affirm the principle that in the case of claims of certain classes, proof of diversion is unnecessary. The difference of opinion between the judges was not upon this proposition, but concerned only the question whether the claim of Gregg fell within the class of claims, the equities of which are such that preference is allowable in the absence of diversion. Both the majority and the minority judges agreed that there was such a class, but they differed as to what claims properly belonged therein. The majority, while declaring that notwithstanding no di-

version had been shown, yet, had the supplies furnished been necessary to the *business* of the road, the claim would have been entitled to preference, held that the supplies furnished by Gregg were not necessary to the business of the company. Preference was therefore denied the claimant. The minority stated in even more emphatic language that diversion was not a *sine qua non* to preference, and held that the claim in its intrinsic nature was such as to entitle it to special consideration at the hands of a court of equity, and that it should have been ordered paid out of the corpus, in preference to the claims of the bondholders.

Considered, now, in more detail the opinions delivered respectively by Justice Holmes and Justice McKenna, it will be seen that the opinion of the former opens with the statement that "the case stands as one in which there has been no diversion of income by which the mortgagees have profited, or otherwise," and the question is said to be whether in a case of that kind the claim could be charged against the corpus. It is then stated that in the case at bar there were "no special circumstances affecting the claim as a whole," meaning evidently that were such equitable features present, the claim would have been entitled to preference.

Referring to the *Miltenberger Case*, the distinction is taken between claims necessarily incurred in continuing the *business* of the road and those incurred merely for its *preservation*; and claims of employees are referred to as examples of the former class. The conclusion reached is that the claim was not entitled to prefer-

ence, not because no diversion was shown, but because of the intrinsic nature of the claim itself, the supplies furnished by the claimant having been used, apparently, in making what is known as a betterment. The rationale of the decision is (1) that claims incurred in continuing the business of the road (whether they be labor claims or supply claims) may be allowed priority, even in the absence of diversion; and (2) that when a diversion has occurred, operation claims in the broader sense, whether necessary to the business of the road or to its preservation, are properly given preference.

The reason for the distinction thus made between cases where there has been a diversion and other cases has already been touched upon. As pointed out (*supra* p. 7), where income has been diverted, the bondholders have obtained something to which they were not entitled, for while railroad mortgages and trust deeds almost invariably in terms include and cover "income," under the unbroken current of authority, the bondholders thereby obtain no lien upon income until it has been sequestered by them through the appointment of a receiver, or otherwise. This being so, and income to which they have no prior claim having been added to properties upon which they have a lien, they are deprived of no rights when upon a sale of such properties an amount equaling the sum diverted is applied to the payment of the "debts of the income."

On the other hand, where there has been no diversion, the creditor must establish the existence of some

“special equity,” to use Judge Holmes’ expression. This special equity always exists where the consideration furnished by the claimant has not merely benefited the mortgagee generally by adding to the value of his security, *but has preserved and enhanced the value of his security in a special sense, by assisting in keeping trains moving on the road.* In so doing, the creditor not only supplies something the value of which to the mortgagee it is difficult to over-estimate, but also (to use the language of Judge Simonton in *Bound v. South Carolina Ry. Co.*, 48 Fed. 189), “suberves the public weal.” Out of these considerations, the “special equity” arises. The test for determining the existence of the latter, as established by the majority opinion in the *Gregg Case* is, therefore, whether the creditor in question supplied something necessary to the *business* of the road, and not merely something properly classed as a *betterment*, or necessary only to its maintenance or preservation.

Now, the dissenting judges in the case under consideration, (and it is interesting to note that all of them are still members of the court, whereas only one of the justices who joined in the majority opinion [Justice Holmes] remains upon the bench, which would seem to point to a return in subsequent cases to the principles of the dissenting opinion) agreed with the majority that preference is allowable in certain cases in the absence of diversion; but they disagreed with them upon the question what these cases were, and emphatically rejected the test laid down by Judge Holmes—that is,

whether the claim was necessary to the *business* of the road, as distinguished from its preservation. After quoting the statement in the *Miltenberger Case* that "many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of its property, for the receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, *or even the corpus of the property*, under the order of the court with a priority of lien," (25 Sup. Ct. 419), and after referring to the fact that the later cases had left undisturbed the doctrine of that case, citing *Union Trust Company v. Illinois Midland R. Co.*, 117 U. S. 434, and *Virginia, etc., Co. v. Central Railroad, etc., Co.*, 170 U. S. 355, and numerous other cases, Justice McKenna said:

"A railroad, from its nature and public responsibilities, must be kept a going concern. This is the supreme necessity, and affords the test of the equity invoked for the claims for supplies. It cannot depend upon diversion of income or upon the existence of income. It cannot be confined to debts contracted during the receivership. It may extend to debts contracted before the appointment of the receiver. But, recognizing that there must be some limitation of time, the courts have fixed six months as the period within which preferential claims may accrue. And there is no infringement of the rights of mortgagees. Their interests are served, and those of the public are, by keeping the railroad in operation."

From the above, we think, it will be clear that the established rule of the Supreme Court is that certain classes of claims are properly allowed preference in the

absence of proof of diversion, and that both the majority and minority opinions in the *Gregg Case* contains a distinct affirmance of this principle. In this circuit, as already shown, and in the majority of the circuits the same doctrine is laid down. In the language of the Circuit Court of Appeals for the Fourth Circuit the allowability of the claim "*does not depend upon diversion, or even upon the existence of income.*" (*Virginia Passenger, etc., Co. v. Lane Bros. Co.*, 174 Fed. 513, 516, decided Dec. 15, 1909.)

With reference to the correctness of the test laid down by Judge Holmes for determining the preferential character of a claim in a case where there has been no diversion, we do not think any discussion is necessary here. Conceding for the purpose of the argument the correctness of this test, and also that (notwithstanding the changes in the personnel of the Court since the *Gregg Case* was decided, which as above suggested apparently makes the then minority, the present majority) that doctrine will be applied in the Supreme Court in future cases, it is nevertheless clear that the claims in controversy are entitled to preference, for they are not claims for betterments merely, and the services and materials covered thereby were not essential only to the maintenance and preservation of the property, but all (as is expressly shown by the record, p. 27), were necessarily incurred in continuing the *business* of the road.

It is conceded by opposing counsel that in the *Gregg Case* the Supreme Court held that certain claims may be ordered paid out of the corpus in the absence of

proof of diversion. But they say that this may be done only when in the course of the administration of the receiver, laborers threaten to quit work unless back wages due them are paid, or when material-men or connecting railroads threaten to discontinue business relations with the receiver unless their claims are paid. The reason for this allowance is founded on what is termed by counsel "the equity of the public," and the proof that the equity does not exist in the present case is said to lie in the circumstance that the road was in fact kept running without payment to any such claimant, and that such payments were not, therefore, necessary to the continued operation of the road.

It is hardly necessary to comment upon the inequity involved in the proposition that men who threaten a strike while in the receiver's employ and who give evidence of their determination to thereby prevent the court from operating it, unless their wages are paid, or supply men assuming a like attitude, stand in a better position than those who faithfully continue to assist in operation of the road. Federal courts have in the past adjudged men guilty of contempt in interfering by a strike with the operation of a railroad by a receiver. Are they now to offer a reward for what they formerly condemned? Is the doctrine to be established that the courts of the United States administering equity may be coerced into awarding priorities?

The admission of counsel that the class of claims referred to by them may be paid out of the corpus is, indeed, fatal to their entire argument; for upon what

principle can such claims be allowed priority and the claims in controversy here be denied it? Is not the equity of those who continue to assist in keeping the road a going concern by staying at their posts in the hour of its grave financial need at least of equal value to the equity of those who during the receivership seek the collection of their claims by threatening a strike or the cessation of business relations? The argument concedes that at the time the services were rendered, or the materials furnished, the equities of the claimants represented by us were the same as those of claimants who, having rendered similar services or furnished similar materials, attempt after the receivership to collect their claims by the coercive means mentioned, instead of by presenting them to the court to be judged upon their merits, as have our clients. Can it be explained how a claim, because of something happening long after its accrual, may acquire additional value and merit in the eyes of a court of equity? And if so, upon what principle does the threat of the claimant, made during the receivership, to strike or to discontinue business relations, unless payment is made, add to his equities?

The rule contended for by the appellants, it is clear, would only put a premium upon interference with the receiver's control, and would tend to prevent, rather than assist in keeping the road in operation. It must be clear that the road can best be kept in operation, and the public can be best served, by laying down, in advance, the rule that men who stay at their posts and assist in keeping it going will be paid at all hazards—not by

saying to them: "You will be paid, only if during the receivership you are able to make yourselves troublesome enough to force the receiver and the court to pay you." We submit, therefore, that the interpretation opposing counsel seek to put upon the *Gregg Case* is unreasonable in the extreme and wholly unwarranted by the language employed by the court.

We may add that if, in the *Gregg Case*, the Supreme Court had considered (as claimed by appellants) that priority can only be awarded to a claimant, who, during the receivership has forced the court into making the order by threatening a cessation of business relations, it is clear they would have said to Gregg in effect: "There is no diversion, and you have come here *after* the sale has been had, and assert a right to share in the proceeds. Now, if you had been furnishing supplies to the receiver while he was in charge, and had come to him and said that you would supply no more until he paid you for those furnished before the receivership; and if he had placed these facts before the judge and the latter had allowed the claim, you would have had some standing here. But you did not do so, and therefore your claim must be disallowed." If the Court had interpreted its decision in the way in which appellants seek to interpret it, they would have disposed of the claim by saying, with counsel in this case, that the road was in fact operated during the receivership and that that was the best proof that the claim was not necessary to the business of the company. Discussion as to the nature of the claim would have been wholly beside the

case. No matter how meritorious it was, it would not (according to appellants' claim), be allowed out of the corpus in the absence of a necessity for the continuation of business relations during the receivership.

At the oral argument, we gathered that opposing counsel claimed that this Court stands practically alone among the other circuit courts of appeal in upholding the doctrine that claims of the kind here involved may be allowed priority in the absence of diversion. We think an examination of the decisions at circuit, however, will show that this claim is wholly untenable, and that the decisions in the other circuits, save in the sixth and eighth (so far as the question here involved has been presented for determination), are in line with the decisions in this circuit. In this connection we will review briefly the authorities cited from the various circuits on pages 57 to 73 of appellants' brief:

FIRST CIRCUIT.

The decisions in *Wood v. New York, etc., Ry. Co.*, 70 Fed. 741, and *New England Realty Co. v. Carnegie Steel Co.*, 75 Fed. 54, are admitted to be in our favor; but it is stated in appellants' brief that after the decision in the *Gregg Case*, the Circuit Court of Appeals for the First Circuit had occasion in *Whelan v. Enterprise Transportation Company* to again consider the same question, and that that court therein adopted the rule contended for by appellants. It will be noted, however, that the decision in the *Whelan Case* was not by

the Circuit Court of Appeals, but by the Circuit Court for the District of Massachusetts. Moreover, even the most cursory reading of the opinion will be sufficient to show that it does not overrule, or attempt to overrule, the decision of the Circuit Court of Appeals for that District, reported in 75 Fed. 54. We are, therefore, justified in stating that the rule of the First Circuit is in harmony with the rule established in this circuit.

SECOND CIRCUIT.

It is not claimed in appellants' brief that there is any decision in the Second Circuit which directly supports their contention, but it is stated that the reports of the Master in Chancery, which were confirmed by the District Court for the Southern District of New York in the New York Street Railway cases, adopt the interpretation of the *Gregg Case* which appellants contend for. We do not so read the Master's report. On the contrary, at page 175 of 208 Fed., we find it stated that "a debt necessary to the business of the company," . . . even under the narrowed "rule laid down in *Gregg v. Metropolitan*, 197 U. S. 183; 25 Sup. Ct. 415; 49 L. Ed. 717, by a sharply divided court, is with claims for labor held entitled to go against the corpus without proof of diversion of current income for its benefit." We are unable to see, therefore, how opposing counsel can get any comfort out of the decisions cited by them from the Second Circuit.

THIRD CIRCUIT.

The decisions in this Circuit are admitted in the brief to be in favor of our contention.

FOURTH CIRCUIT.

The last case decided in this Circuit, *Virginia Passenger Co. v. Lane Bros. Co.*, 174 Fed. 513 (which is not cited in appellants' brief), supports our interpretation of the *Gregg Case*, the court saying that the allowance of priorities "does not depend upon the diversion or even upon the existence of income." (p. 516.)

See, also,

Lee v. Pennsylvania Co., 145 Fed. 405 (Cir. Ct. E. D. Pa.).

The rule in that Circuit is, therefore, in harmony with the decisions in the ninth.

FIFTH CIRCUIT.

On page 63 of appellants' brief the case of *Farmers Co. v. Vicksburg Ry. Co.*, 33 Fed. 778, and *Clark v. Central R. R. Co.*, 66 Fed. 803, are cited in support of the statement that: "The theory which requires proof of a diversion of income for the allowance of a priority, with the single exception above referred to, has been definitely adopted as a rule of this Circuit." Upon examination, however, it will be seen that neither of those cases support counsel's claim that claims of this character may be allowed only upon proof of diversion.

SIXTH CIRCUIT.

The decisions in this Circuit and in the Eighth Circuit, as we have already stated, are against our position. Those two circuits we think, however, stand alone.

SEVENTH CIRCUIT.

None of the decisions from this Circuit cited in appellants' brief, as we understand them, support their posi-

tion. In *Calhoun v. Railway Company*, 14 Fed. 9, the question whether priority could not be allowed in the absence of diversion was not considered.

Thomas v. Peoria Ry. Co., 36 Fed. 808, cited on page 65 of appellants' brief, is an authority in our favor. In that case Judge Harlan, delivering the opinion of the Court, said, quoting from the *Miltenberger Case*:

"Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, or even the corpus of the property, under the order of the court, with a priority of lien."

In the next case cited, *Farmers L. & T. Co. v. Green Bay Ry. Co.*, 45 Fed. 664, the Court said:

"The exercise of this equitable power in the court is not, however, dependent upon diversion of current earnings to payment of bonded interest, leaving current expenses unpaid, but is exercised as well in consideration of the fact that, in case of failure of the trustee to take possession upon default, it is indispensable to the preservation of the property, and its maintenance in integrity, that it should be operated. It must be kept a going concern."

We find nothing in the case of *Mather, etc., Co. v. Anderson*, 76 Fed. 164, which tends to support in any way appellants' contention. It is therefore submitted that the decisions in this Circuit, so far from being adverse to our position, support it.

We have already adverted to the decisions in the Eighth and Ninth Circuits, and therefore pass by without further discussion pages 65 to 73 of appellants' brief which are devoted to a discussion thereof.

On pages 73 to 80 of appellants' brief it is argued that no claimant can profit by a diversion unless he shows that it occurred after his indebtedness became payable. This matter is discussed in the Master's report (pp. 36-38), where the argument is fully answered.

II.

THE FACT THAT THIS SUIT WAS INSTITUTED BY AN UNSECURED CREDITOR AND NOT BY THE TRUSTEE DOES NOT PRECLUDE THE ALLOWANCE OF PRIORITY TO THE CLAIMS IN QUESTION.

Under this heading we shall first discuss the proposition contended by opposing counsel that the rules respecting priorities, which are applied in creditors' and stockholders' suits are different from those applied in proceedings for foreclosure. We think that we shall be able to show that upon principle and by the overwhelming weight of authority precisely the same rules are applicable in both forms of action. We shall also contend that the record here shows that the trustee stands in precisely the same position, so far as concerns the application of the maxim, "He who seeks equity, etc.," as would have been the case had he been the formal plaintiff in the suit.

1. *The same rules respecting the allowance of pri-*

orities are applied in creditors' suits, as in proceedings for foreclosure.

In cases where there has been a diversion, we are inclined, after a review of counsel's brief, to doubt whether they seriously claim that the mortgagee would be entitled to receive the amount returned into court after the sale, representing the sum so diverted. If the mortgagee could claim this, he could also claim income not diverted, and this, notwithstanding it is admitted that he has no claim to income, excepting only after the "debts of the income" have been paid. We have the authority of opposing counsel themselves, that a mortgagee has no lien excepting upon the *net* income, and then only after the mortgagee has caused it to be sequestered by the appointment of a receiver. (Appellants' brief, p. 15.) What possible difference can it make with respect to the right of the mortgagee to this property, which (whatever its form) admittedly was not covered by his contract, whether he or someone else asked for the appointment of the receiver?

Courts of equity are not so powerless that they can give to one class of creditors, that to which they are admittedly entitled, *only* when the representative of another class invokes jurisdiction. If this were so, secured creditors would become the owners of that to which concededly they never were entitled, merely by "standing away" from a court of equity (to use an expression counsel somewhere employ), and unsecured creditors never could obtain their due unless perchance the trustee found itself forced to go into courts as plaintiff.

But the authorities do not stop at the point of recognizing that in cases where there has been a diversion there is no possible ground upon which the trustee, whether it be plaintiff or defendant, may avoid restoring that which (to use counsel's words) "he has wrongfully or inequitably obtained." On the contrary, they broadly declare (as we understand them) that irrespective of the question of diversion and irrespective, also, of who may or may not be the plaintiff in the proceeding, priority over the mortgage indebtedness may be allowed, out of the corpus, to certain claims, which, because they were necessary to the business of the road, are regarded as particularly meritorious.

In an article on the subject of Railroad Receiverships, which may be found in 30 Am. Law J. 168, Judge Caldwell thus explains the origin of the practice of imposing conditions in orders appointing railroad receivers. Said he:

"Another benefit inuring to the railroad company and its mortgage bondholders from a railroad receivership, was the opportunity it afforded to escape the payment of all obligations of the company for labor, supplies and materials furnished and used in the construction, repair and operation of the road. *Whenever a railroad company became so largely indebted for labor, material and supplies and other liabilities incurred in operation of its road that it could profitably pay the expenses incident to a receivership and foreclosure for the sake of getting rid of its floating debt, it sought the aid of a friendly mortgage bondholder, through whose agency it was quickly placed in the hands of a receiver, and immediately a court of equity was asked and expected to do the mean things which the company was unable or ashamed to do.'*"

He then instances the case of the Memphis & Little Rock Railroad Co. which went through four successive receiverships, in two of which it succeeded in defeating the claims of all its unsecured creditors. After the first sale, substantially the same persons who were originally interested in the enterprise reorganized as the Little Rock & Memphis Railway Co. Upon the next sale, Judge Caldwell says they "started in at the other end," and called the new company the Memphis & Little Rock Railroad Company. The next time, it was given the name of Memphis & Little Rock Railway Company. Aside from the new name and the elimination of the unsecured indebtedness, the reorganization wrought no change.

It was to prevent abuses of this kind that the rule of making the appointment of railroad receivers in foreclosure suits conditional upon the payment of the unpaid operating expenses was adopted. Such orders are unquestionably proper, but it is not, and never has been the rule that unless the mortgagee invokes the jurisdiction of the court such claims must remain unpaid. Certainly, the cases cited by counsel do not bear out this claim. The most they establish is that the fact that the trustee is seeking the aid of the court justifies the imposition of reasonable conditions upon him. None of them support the proposition that this circumstance is a *sine qua non* of the allowance of priorities, and the cases overwhelmingly declare the opposite rule.

Certainly the case of *Fosdick v. Schall*, 99 U. S. 235, cited on page 84 and elsewhere in appellants' brief, does

not sustain their position. In that case, the receiver was appointed at the instance of the trustee; and the claim was denied preference, not upon any consideration as to who was or was not the plaintiff in the suit, but because of the intrinsic nature of the claim itself. The claim was based upon a car-trust agreement, under the terms of which the claimant retained the title to the cars affected thereby, together with the right to reclaim the same upon default made by the railroad company. In fact, the owner did reclaim before the sale (p. 255).

The case presented, therefore, was the familiar one of a claimant who had security for his debt, in that he retained the title to the cars in question and possessed the right to reclaim the same. The claim in its nature was clearly not preferred, and it was for this reason, and not upon the ground that Schall's petition in intervention was filed in a proceeding instituted by a creditor (for it was not) that the claim was denied preference. The sentence in the opinion which is relied upon by opposing counsel, to the effect that if a mortgagee asks no favors he need grant none, was clearly *obiter dictum*. Moreover, as we shall presently point out, the mortgagee in the present case cannot successfully contend that it asked no favors of the court. On the contrary, it sought and obtained relief as its hands in enforcing its security, and this relief (however counsel may now seek to belittle it), undeniably was of the utmost value to it. It is hardly necessary to add that the rule, "He who seeks equity," etc., is not applied solely to the plaintiff

in equitable proceedings, but to *any* party seeking or obtaining any relief therein.

In passing from this case, it may be said, lest we be misunderstood, that we deny that it is necessary that a mortgagee should "grant favors" before priorities may be awarded to operation creditors. As we have already pointed out (*supra*, p. 3), the decisions declare that the mortgagee of railroad property is presumed to lend his money with full knowledge of the law that permits other meritorious claims to be paid from the proceeds of sale, in advance of his claim. It is not the rule that an equity first in time is always first in right. On the contrary, time is ordinarily the least important of the considerations entering into the determination of the relative value and merit of equities. All this the bondholder is presumed to know, and particularly that by a mortgage of this kind of property, the mortgagee's claim to the corpus may be postponed in favor of certain other limited classes of claims possessing in the eyes of a court of equity a peculiar intrinsic value.

The *Kneeland Case*, 136 U. S. 89, cited in appellants' brief (p. 85), is readily distinguishable. The claim there involved, like the last, was based upon a car trust agreement, and was clearly not preferential in character. The claimant, whose debt was secured by a lien on the cars, was insisting upon being allowed preference out of the realty. (See p. 99.) But for one circumstance, his claim plainly would have fallen within the rule which denies a preference to secured creditors. This circumstance was that the claim had accrued dur-

ing a prior *receivership*. By reason of this circumstance, it was asserted that this claim, which, as stated above, in its nature, was clearly non-preferential, was entitled to priority over the claims of the mortgage creditors.

It thus became necessary to inquire into the nature of the prior receivership and to ascertain whether the mortgagee was responsible therefor. If that question should be answered in the affirmative, it would have presented the situation of one's practically incurring an indebtedness and then attempting to repudiate it. It would have placed the mortgagee in a situation where it could not, equitably at least, have denied the force and binding effect of the claimant's equity.

But the question could not be answered in the affirmative. The receiver had not been appointed at its instance, and therefore the claimant could not lift himself above the rule above referred to, which denies preference in these cases to secured creditors. This is all that the *Kneeland Case*, which is so frequently cited by opposing counsel, amounts to or decides. It is clearly no authority in favor of appellants.

The correctness of these observations is clearly shown, we think, by the later case of *Kneeland v. Foundry & Machine Works*, 140 U. S. 562. The claim there involved was for *supplies* furnished to Dwight, the receiver appointed in the creditors' suit—the same one referred to in the *Kneeland Case* reported in 136 U. S. The lower court allowed the claim, and an appeal was taken from this decree. The Supreme Court clearly

pointed out the distinction between the claim involved in the case in 136 U. S. and that then before the court, and affirmed the judgment allowing the claim.

In *Virginia, etc., Coal Co. v. Central Railroad, etc., Co.*, 170 U. S. , 18 Sup. Ct. 657, cited in appellants' brief (p. 88), there was a stockholders' bill, a bill by the mortgagor (under both of which receivers were appointed), and later a bill by the trustee, the earlier receivership being extended to that bill also. The claim was for coal purchased for use in the operation of the road, and was presented by a bill in intervention *filed in the stockholders' suit*. The Supreme Court held it was properly allowed preference, as an operating claim accrued prior to the receivership.

The case was similar to the one at bar in that it was not originally inaugurated by the trustee. Later, however, the latter asked and obtained the aid of the court, and a sale was had, precisely as in this case, the only difference being that in that case the trustee filed a bill for that purpose, while here the same object was accomplished under the return to the orders to show cause, and by the subsequent proceedings had in open court.

But aside from this, the Supreme Court evidently considered the form of the proceeding in which the claim of the intervenor was presented and the status of the complainant therein (she was a stockholder) as a matter of no moment. See statement of the court on page 663 of 18 Sup. Ct., referring to the agreed statement of fact on which the case was presented:

"The circumstances that it is uncertain from the terms of the stipulation whether the expenditures for betterments were made by the receivers under the stockholders' bill, or under the bill filed by the Central Company, or under the trustee's bill for foreclosure, is immaterial."

Finance Co. v. Charleston, etc., Ry. Co., 49 Fed. 693, cited on page 85 of appellants' brief, so far from lending any support to counsel's contention, favors rather our own. Judge Simonton there explains the *Fosdick Case*, stating that when the mortgagee, by obtaining the appointment of a receiver "suddenly removes the employer from control of the current earnings," the court "without considering liens or equities, acting only in its own discretion," imposes conditions upon the suitors."

"This," he continues, "is not a right vested in the employees, or an equity administered in their favor. It is a personal protection given to them by the court *ex gratia*, moved thereto by the fact that this class depend upon their daily labor for their daily food. *Afterwards when the court has assumed the administration of the property, and it appearing that there are certain outstanding claims in the hands of persons who furnished equipment materials, supplies, or anything which was necessary to keep the railroad a going concern, then the court administers an equity, and the benefits of this equity inure as well to the original parties keeping up the road as to their assignees.*"

Clyde v. Richmond, etc., Co., 56 Fed. 539, was also decided by Judge Simonton. The suit was instituted by persons who were not mortgage creditors. The court affirmed the proposition that preferences may be al-

lowed against the corpus even in the absence of diversion, and declined to dismiss the petition. On the contrary, the latter was ordered "retained, in order, if possible, to assist the petitioner in obtaining payment of her claim, which is so manifestly just." It was held, however, that the proper forum for the presentation of the claim was that in which the original proceeding under which the receivers were appointed were had, and the determination of the matter was left to that court. It is difficult to see wherein this case supports the contention of the purchasers.

In *St. Louis Ry. Co. v. Holbrook*, 73 Fed. 112, cited in appellants' brief (p. 88), it was held that it was proper to require, as a condition of appointing a receiver in a foreclosure suit, that claims for personal injuries incurred in the operation of the road prior to the receivership should be satisfied. The case lends no support to the claim that operation claims can be ordered paid in preference to the mortgage indebtedness only when the mortgagee is the plaintiff. It illustrates, however, that in the opinion of the court it was proper in a case so instituted to require claims to be paid (in this case, a claim for personal injuries), which otherwise would clearly not have been entitled to preference. In other words, the general doctrine was not denied in the case referred to; its application was merely extended.

In *New England R. R. Co. v. Carnegie, etc., Co.*, 75 Fed. 59, the Circuit Court of Appeals for the First Circuit declared that a supply creditor was entitled to be paid out of the diversion. The suit was originally

brought by one who held a few first mortgage bonds, and some of the stock of the mortgagor. The object of the bill was merely to obtain the appointment of a receiver to keep the system intact, no foreclosure being sought. Later, the trustee of the second mortgage filed a bill for foreclosure of said mortgage. The court, as already stated, allowed the claim against the corpus, but declined to give any opinion as to whether it would have made any difference if the trustee had not asked for foreclosure of its mortgage and for the appointment of a receiver.

The case in 128 Fed. 209, is not in point. (See remarks *supra*, with reference to *Kneeland v. Trust Co.*)

The above are all of the authorities cited by opposing counsel in support of their claim that it is a necessary condition of the allowance of preference to claims for operation that the proceeding should have been inaugurated by the mortgagee. We think that we have shown that none of them sustain their position.

We beg, now, to refer briefly to some of the authorities relied upon by us.

In *Union Trust Co. v. Illinois Midland Co.*, 117 U. S. 434, 458, the same distinction here attempted to be drawn between suits in which the mortgage is the *actor* and others was urged. The unanimous judgment of the court rejected the distinction, Mr. Justice Blatchford, who delivered the opinion, saying:

“In this connection it is objected that in those cases the suits for foreclosure suits brought by trustees under mortgages, and that a different rule should obtain in a

case where the trustees or bondholders do not come into court initially, asking the aid of equity in the appointment of a receiver. It is said that the Hervey suit was not such a suit. But the co-plaintiffs with Hervey were judgment creditors of the Paris and Decatur Company, with executions returned unsatisfied. The bill set out the precarious condition of all the property held and used by the Illinois Midland Company, and the necessity for a receiver in the interests of all the creditors of all four of the corporations, to prevent the levy of executions on such property; and it prayed for a judicial ascertainment and marshalling of all the debts of all the corporations, and their payment and adjustment as the respective rights and interests of the creditors might appear, and for general relief. The plaintiffs set forth that they represented a majority of the stock in all the corporations. *This bill was quite sufficient to enable a court of equity to administer the property and marshal the debts, including those due the mortgage bondholders, making proper parties before adjudging the merits."*

It will be observed that in the case mentioned, the proceeding was brought by one Hervey, a stockholder, and two judgment creditors. (117 U. S. 441.) On the same day the bill was filed, the railroad company, mortgagor, appeared, following a practice which is not at all unusual in these cases, waived notice and submitted itself to the order of the court. A receiver was at once appointed. It is true that later certain mortgagees filed bills of foreclosure, but that fact was not referred to by the court in this connection, and apparently was not deemed a matter of any importance in the solution of the question whether the claims in question were entitled to priority.

In *Sage v. Memphis, etc., R. R. Co.*, 125 U. S. 375,

the last cited case was followed, the court quoting with approval the above language of Mr. Justice Blatchford.

In *Southern Ry. Co. v. Carnegie Steel Co.*, 76 Fed. 492, 20 Sup. Ct. 347, Clyde and others, stockholders and creditors of the Richmond and Danville Railroad Co., filed their bill against said company for the purpose of having a receiver appointed and thus protecting it from attachment suits pending the adoption of a plan of reorganization. The Carnegie Steel Company presented a claim for steel rails sold the company.

In affirming the decree of the lower court allowing the claim as a preferential one, the Circuit Court of Appeals for the Fourth Circuit, after referring to the familiar rule that a railroad mortgage of income covers only net income, said:

“If this be the law when a receiver is appointed at the instance of mortgagees, how much stronger is the equity when the receiver is appointed at the instance of stockholders, to secure uninterrupted opportunity for a satisfactory reorganization? The question is as to the application of those principles to the case at bar. There can be no question that the steel rails furnished by the Carnegie Steel Company come within the class of supplies necessary to keep the railroad company a going concern; and the evidence establishes the fact that, after incurring the debt, the railroad company was in the receipt of large earnings, which were applied to permanent improvements, rentals, and interest on the mortgage debt.” . . . “The supplies were furnished between July and October, 1891,—the first of them nearly eleven months, the last a few days more than nine months, before the appointment of receivers in the Clyde case. In the cases in the Supreme Court and on circuit in which this consideration for the claims of supply creditors is

discussed, it is called an "equity." The only qualification in applying the equity when the facts call for its exercise is that the claim has arisen within a reasonable time before the receiver was appointed. No fixed definition of a reasonable time has been adopted." . . .

"The system had become too extended and needed reorganization. Those interested in it as stockholders and owners attempted plans of reorganization, but did not get the unanimity necessary to perfect them. *They sought the aid of the court, and asked its protection from creditors until such time as a scheme of reorganization could be completed and adopted. Their prayer was granted, and the receivers appointed. This whole action was for the advantage of those who owned or were interested in the property of the railroad company, for their advantage primarily and principally, if not for their advantage solely. But for this intervention in behalf of these stockholders and creditors, their taking the property out of the hands of the company, and sequestering it for their own purposes, it must be presumed that the notes of the Carnegie Company would have been met at maturity.*"

In the Supreme Court the decree was affirmed. (See 20 Sup. Ct. 362, where the circumstance that the plaintiff in the *Clyde Suit* were stockholders and creditors is referred to and a part of the opinion of the Circuit Court of Appeals with reference to that point is quoted with approval.)

In *Veatch v. American, etc., Co.*, 84 Fed. 274, Mr. Justice Brewer, delivering the opinion of the Circuit Court of Appeals for the Eighth Circuit, said:

"It will be noticed that a railroad receivership may be at the instance of the mortgagee, or of a judgment

creditor, or of a stockholder. If at the instance of the mortgagee, the income is impounded for its benefit; if of a judgment creditor, for the payment of his judgment. There is in the latter case an equitable levy on such income, and the mortgagee can claim no superior right thereto."

In view of the foregoing, we respectfully submit that the contention of the purchasers with respect to the form of the present proceeding as a reason for disallowing priority to the claims under consideration is wholly untenable and must be overruled.

2. *The trustee has applied for and obtained relief in this proceeding, and the maxim "He who seeks equity, etc.," is therefore applicable to it.*

It is idle for appellants to claim that the trustee might have enforced its security without the aid of the court. Technically and formally, the deed of trust or mortgage authorized it to do this, but as a practical matter it did not possess the power; for without a decree no purchaser would have taken the property. To have done so would merely have been to invite innumerable law suits. The trustee was therefore obliged to seek and obtain the aid of the court in *some* proceeding, and it did this in the present one. The result was that the bondholders realized upon their security and the trustee obtained compensation for the services performed by it and by its attorneys. Whether the sale was made up on the petition of the trustee or not is wholly immaterial. It, at least, applied for and obtained substantial relief in the proceeding.

For the reasons stated, it is respectfully submitted that the decree should be affirmed.

Respectfully submitted,
GOODFELLOW, EELLS & ORRICK,
Solicitors for certain Claimants.

No. 2353

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CHARLES C. MOORE, F. W. BRADLEY, MAURICE
SCHWEITZER, R. D. ROBBINS and WALTER
S. MARTIN,

Intervenors and Appellants,

vs.

F. L. DONAHOO et al.,

Appellees.

REPLY BRIEF FOR APPELLANTS.

At the oral argument of this cause two briefs were filed, one by Messrs. Sullivan, Sullivan and Theodore J. Roche, in behalf of certain labor claimants, and the other by Messrs. Goodfellow, Eells & Orrick, in behalf of certain labor and supply claimants. At that time permission was granted us by the court to file a reply to these briefs. This brief is our reply.

Counsel for claimants have taken issue with us directly upon the three propositions which we laid down in our opening brief, and they make the following contentions: (1) That the claims represented by them, which are for supplies and services furnished prior to

the appointment of the receiver and which were necessary to the conduct of the business of Ocean Shore Railway Company prior to the appointment, are entitled to preferential payment in the absence of any diversion; (2) that, if supply and labor claimants are entitled to priority only upon proof of a diversion, claimants are not required, as a prerequisite to an allowance, to show that there was a diversion of current income after their claims became payable; (3) that the fact that the receiver in this case was appointed at the instance of an unsecured creditor does not in any way affect the allowance of priorities to claimants.

We shall consider these points in the order named.

I.

CLAIMANTS CANNOT ENFORCE PRIORITY AGAINST THE CORPUS OF RAILROAD PROPERTY UNLESS THERE HAS BEEN A DIVERSION OF CURRENT INCOME, AND THEN ONLY TO THE AMOUNT OF THE DIVERSION.

It will be recalled that, in our opening brief, we suggested as correct the rule that, in the foreclosure of a railroad mortgage, pre-receivership debts incurred within six months preceding the appointment of a receiver may not be paid out of the corpus of the property and prior to the bonded indebtedness, even when the action is instituted by the trustee, (1) unless current income from operation during that period has been diverted from the payment of operating expenses to the benefit of the mortgagee, and then only to the extent of

the diversion; or (2) unless the payment of such claims is indispensable to the continued operation of the property and the preservation of the trust *res*,—the railroad property. We pointed out, at that time, that we believed it to be the rule that where, in an action instituted by the mortgagee, current income during the receivership itself or during a limited period preceding the appointment of a receiver has been diverted from its normal use—the payment of operating expenses—to the satisfaction of the mortgage debt, or to the payment of construction charges, or to the acquisition of improvements or betterments which have increased the security of the bondholders, the mortgagee will be forced to restore, for the benefit of creditors, that which should, in the ordinary course of business, have been devoted to the payment of their claims. That this proposition is correct counsel for appellees have conceded in their arguments and briefs.

Our next contention was and is that it is only when current income from operation has been diverted that claimants may enforce priorities. This contention counsel claim is not correct. They assert that, whereas diversion of income is one ground for the allowance of priorities, those who furnish labor or material necessary to the ordinary and normal operation of a railroad prior to the appointment of a receiver may enforce the prior payment of their claims from the proceeds of sale, irrespective of diversion. The single question at issue on this branch of the argument is thus clearly

shown. We contend that claimants can only enforce priorities against the bondholders when they are able to show that current income has been diverted. We make no exception to the rule thus stated that claimants may enforce such payment only when diversion is shown, because it is apparent to us that it is only under these circumstances that claimants themselves have any equities which will entitle them to the allowance. We do, however, admit that there is another case in which such claims may properly be ordered paid out of the property itself by the court, even though there has been no diversion,—the case, namely, where, without their payment, the continued operation of the property will be jeopardized,—that exception being based on the right and duty of the court to preserve the corpus, and not on any equity of claimants.

We would be satisfied in leaving this branch of the argument as we made it in our opening brief were it not for what we believe to be important inaccuracies met with in the brief of Messrs. Goodfellow, Eells & Orrick in the discussion by that firm of the subject here considered. In answering the brief above referred to we shall examine (1) the principle upon which it is therein asserted that the doctrine of priorities against corpus of railroad property is based; (2) the latest decision of the Supreme Court upon the subject,—*Gregg v. Metropolitan Trust Co.*, 197 U. S. 183; (3) the previous decisions of the Supreme Court and the decisions of the Federal Court referred to in that brief.

(a) *Appellees have neither explanations nor authority for the rule contended for.*

Confronted with a situation in which a railroad corporation has issued bonds secured by a valid deed of trust covering all property and all income in specific terms, and in which, after the issuance of such bonds, various unsecured indebtedness has been incurred in the necessary operation of the railroad, counsel lay down the broad and very general rule that, under such circumstances, claimants will be awarded in a court of equity a lien prior to and ahead of that of the bondholders both upon the income derived from the operation of the properties and upon the properties themselves. In so far as income is concerned, we may, for the purposes of this argument, concede the validity of the rule, although we may remark in passing that it is not correct unless to it is added the restriction that the trustee does obtain a lien upon income when it takes steps to have it sequestered. It will be recalled that a mortgagee, in accepting his security, has been held in innumerable instances to have contracted with the implied understanding that income shall first be used to pay the expenses of operation, and that, until steps are taken by the mortgagee to have income sequestered for his benefit, the first lien of the mortgagee shall be a first lien upon net income alone, and not upon gross receipts. What is the theory upon which counsel rely in advancing the contention that the mortgagee's lien upon the property itself may be postponed until unsecured indebtedness of the railway company has been paid? We search in vain for an explanation of the

contention in the brief of Messrs. Sullivan, Sullivan and Roche. It is true that it is in that brief suggested that, because employees of the company have performed services necessary to the business of the road, and thus contributed to keep the road in operation, they should be given an equitable lien; but the fact that such claimants may be entitled to an equitable lien furnishes no ground for the conclusion that such an equitable lien will be entitled to a prior payment out of property already conveyed to others as security for advances made by them.

Dismissing, therefore, for the present, the brief of Messrs. Sullivan, Sullivan and Roche, we turn to that of Messrs. Goodfellow, Eells & Orrick. It is therein pointed out (page 3) that railroad property is "held to be subject to rules which are not applied to other property"; that "ejectment cannot be maintained against a railroad to recover a right of way"; that its "rolling stock and other property necessary to the operation of the road cannot be subjected to attachment"; that "the rights of mortgage creditors of a railroad are different in some respects from those of ordinary mortgage creditors"; that "in legal proceedings involving railroad mortgages principles are properly applied which are not met with in other cases"; that "to apply these principles is not to rob the mortgagee of any of his rights * * * but merely to enforce those actually obtained by him under his contract"; that "one who invests his money upon the security of railroad property does so knowing that by reason of the interest possessed by the public the rights

obtained by him are less extensive than they would be if the security were of a different character." (Page 6.)

We think the court will appreciate that, to those anxious to determine the basis of counsels' claim, these statements are most unsatisfactory in their indefiniteness, and we confess ourselves at a loss as to the construction counsel would have us put upon them. We assume that counsel would not argue to this court that the lien of the trustee is a valid first lien upon property described in the deed of trust, but that, because of the public necessity that the railroad continue in operation, that lien will be postponed for the benefit of unsecured creditors. The weaknesses of such a contention are too apparent to require a citation of authority that this would be the very taking of private property for public use prohibited by federal and state constitutions. We feel certain that, if the arguments of counsel mean anything, they mean that a mortgagee who lends money upon the security of railroad property does so with the implied understanding that the lien secured by it upon the property itself is subordinate to that of those who furnish either supplies or labor which contributed to keep the road a going concern; that the lien is not in fact a first lien at all, but it is subject at all times to the claims of unsecured creditors who have assisted in operating the road. There are numerous answers which might be made to this suggestion on principle, as, for instance, the one that it gives creditors an unqualified right against corpus while limiting them, in their rights against income,—concededly a more available fund—to income up to the time of sequestration, an impossible

result; but we do not feel called upon to enter into a discussion of the suggestion for the reason that there is no authority in any jurisdiction which declares that there is such a rule. It has never been held that a mortgagee contracts with any such understanding, and it has, on the contrary, been asserted that the mortgagee has an unassailable first lien upon the property itself which, even in a foreclosure proceeding instituted by it, will only be postponed to force a restoration of that which it has inequitably obtained.

Numerous cases have been cited by counsel which it is evidently desired that this court should construe as supporting the theory that the mortgagee by implication agrees that the first lien of the mortgagee upon corpus is not a first lien so far as the claims of operating creditors are concerned. We believe that it requires no more than a superficial examination to show that not one of these cases supports that contention, and we shall ask the court's indulgence while we briefly consider them. We shall, in each instance, give the number of the page in the brief of Messrs. Goodfellow, Eells & Orrick in which the case considered is discussed.

In

Bound v. South Carolina, etc., Ry. Co., 50 Fed.
312 (page 4),

there is not a suggestion that the first lien of the mortgagee upon corpus is in any way restricted. The court says:

“The consideration which moves the sovereign to bestow this high sovereign prerogative—the right of eminent domain—is the public use of the rail-

road, when built; that it remain of use, that it be and remain a going concern. To this end the first *application of its earnings* must be made. The stockholder subscribes, and the bondholder lends his money, with knowledge of this. Neither of them can get anything until the current expenses are paid."

The discussion is directed to the disposition of income, and to that question alone.

In

International Trust Co. v. Decker Bros., 152 Fed. 82 (page 5),

the statement of the court that any person who accepts a mortgage upon the property of a railroad does so with reference to the law governing such corporations, and with knowledge of the legal condition that, for the purpose of keeping the enterprise a going concern, receivers may be appointed and receivers' certificates issued which may supplant the mortgage, is one not at this date open to question. There is no doubt, of course, on the basis of all the better-considered authorities, that in a receivership the expenses of continued operation may properly be made a first lien upon the property, if the occasion requires.

In

Virginia Passenger Co. v. Lane Bros. Co., 174 Fed. 513 (page 5),

the same rule is referred to, and it is held that a railroad property in the hands of a receiver must be kept in operation. This principle which we have, from the start, conceded, is, it is plain, in no sense authority for

the contention that the expenses of operation before the appointment of a receiver are entitled to a payment out of corpus prior to that of a previously vested deed of trust, or that the trustee impliedly agreed that this should be so.

The other cases cited on page 6 of counsels' brief are even less in point upon the question here presented than the ones already referred to. *Fosdick v. Schall* we have discussed in our opening brief (page 20); the other cases deal generally with the interest of the public in the use of railroad property and do not in any way concern creditors' liens on corpus. The cases referred to on page 7 of counsels' brief do not in any sense serve as authority for the argument here considered, while those listed on page 8 determine, not that delay by a mortgagee in taking possession justifies the allowance out of corpus of pre-receivership debts, but, on the other hand, that indebtedness of the receiver incurred during the time during which the trustee delays in taking possession of the property may be paid with resort, if necessary, to the corpus of the fund—another illustration that a court may, in its conduct of the property, resort to corpus for the payment of expenses incurred by it.

From this examination of the authorities, it is apparent that not one case cited by counsel is authority for the contention that a mortgagee enters into his contract with a railway company with the understanding that his first lien upon the property conveyed is subject to that of unpaid operating creditors, and it is submitted that there is no decision to that effect.

Concluding, then, that there is no case which decides that a mortgagee impliedly consents, upon the execution of the trust deed, that his lien shall be subordinate to that of six months' operating and supply creditors, we must next determine whether the authorities, by implication, support that rule. It must be conceded that in the decisions of this circuit, both of this court and of the Circuit Court and in the decisions of certain District Courts, priorities have, without definite explanations of principle, been allowed in the absence of diversion, and when there was no showing that it was necessary, from the point of view of the receiver, that the indebtedness be paid; but that rule, we submit, has been directly disapproved by the Supreme Court, and is not now the principle followed by any Court of Appeal other than that of this circuit. Concededly, the most important decision upon the subject is that of the Supreme Court of the United States in *Gregg v. Metropolitan Trust Company*, *supra*.

THE GREGG CASE.

This case is fully discussed by us in our opening brief (pages 50 to 57), and no useful purpose can be served by our repeating here what is there said. We should be content to leave our earlier comment on that case without further amplification were it not for the inaccurate statements of fact made by Messrs. Goodfellow, Eells & Orrick with regard to the problem before the court and its solution of it. These inaccuracies are apparent from the most superficial examination of the opinion. We shall quote from counsels' brief the por-

tions to which we take exception, and attempt in each instance to show the basis of our criticism.

(a) Counsel say, at pages 31 and 33:

“Now, the dissenting judges in the case under consideration (and it is interesting to note that all of them are still members of the court, whereas only one of the justices who joined in the majority opinion (Justice Holmes) remains upon the bench, which would seem to point to a return in subsequent cases to the principles of the dissenting opinion) * * *.” (Page 31.)

“Conceding for the purpose of the argument the correctness of this test and also that (notwithstanding the changes in the personnel of the court since the Gregg case was decided, which as above suggested apparently makes the then minority the present majority) * * *.” (Page 33.)

These suggestions require only two comments: (1) The members of the court who dissented from the majority opinion were Justices McKenna, White and Harlan, the latter of whom is now deceased. Of those who concurred with Mr. Justice Holmes, Mr. Justice Day is still an active member of the court. Counsel are, therefore, in error when they say that “only one of the justices who joined in the majority opinion (Justice Holmes) remains upon the bench”; and they are equally in error when they say that “all of the dissenting judges are still members of the court.” Two of the justices who joined in the majority opinion and two of those who joined in the minority opinion remain upon the bench. (2) Our second comment is a frank astonishment at the argument suggested. We had not supposed that the binding force of court decisions hinged

upon the longevity of the members of the court who were responsible for them. And we may candidly add that, counsels' suggestion to the contrary, we have not changed our minds!

(b) We quote from pages 28, 29 and 31 as follows:

“The majority, while declaring that, notwithstanding no diversion had been shown, yet, had the supplies furnished been necessary to the business of the road, the claim would have been entitled to preference, held that the supplies furnished by Gregg were not necessary to the business of the company.” (Pages 28 and 29.)

“Referring to the Miltenberger case, the distinction is taken between claims necessarily incurred in continuing the business of the road and those incurred merely for its preservation; and claims of employees are referred to as examples of the former class.” (Page 29.)

“the test laid down by Judge Holmes—that is, whether the claim was necessary to the business of the road as distinguished from its preservation.” (Pages 31 and 32.)

There are other statements to the same effect, namely, that the test applied by the majority of the court is whether the supplies furnished were necessary to the business of the road or merely necessary to its preservation.

This is what the court said:

“The ground of such allowance as was made was not merely that the supplies were necessary for the preservation of the road, but that the payment was necessary to the business of the road,—a very different proposition.”

“But even if any words in the order authorized a charge on the corpus in order to pay claims like

that of the petitioner, or a payment of them except from income, certainly there are none requiring it, or going beyond giving authority to the receiver if, for instance, he thought payments of previous debts necessary to the continued operation of the road.”

“The petition on which the original order was made stated that the money was wanted to pay certain obligations, ‘or so much thereof as may be necessary’ embodying the distinction which we have drawn from the cases.”

The distinction made is clear, and it is not what counsel would have us believe they think it is. It is between a situation where it appears that services or supplies “were necessary to the preservation of the road”—where priority will be denied—and a situation where *payment* for supplies was necessary—as Mr. Justice Holmes says, a very different proposition.

The master has thus aptly stated the rule of the *Gregg* case (Report on Law, page 77):

“The necessity of the supplies themselves is an immaterial factor. What the majority opinion emphasizes as the explanation contained in the Miltenberger case is the *necessity of payment*.”

(c) We now refer to the following statement of counsel:

“The conclusion reached is that the claim was not entitled to preference, not because no diversion was shown, but because of the intrinsic nature of the claim itself, the supplies furnished by the claimant having been used, apparently, in making what is known as a betterment.”

There is not a mention of the word “betterment” in the majority opinion, and the claim consid-

ered in the *Gregg* case was, in no sense, that. It was, in fact, stipulated and was recited in the course of the opinion that

“The claim is for necessary operating expenses in keeping and using said railroad and preserving said property in a fit and safe condition.”

The claim is identical in its character with those set forth in Exhibit B of the record in our case. It was an operating claim and was so treated by the court.

(d) Counsel further say:

“The rationale of the decision is (1) that claims incurred in continuing the business of the road (whether they be labor claims or supply claims) may be allowed priority even in the absence of diversion; and (2) that when a diversion has occurred, operation claims in the broader sense, whether necessary to the business of the road or to its preservation, are properly given preference.”

With no desire to be offensive, we can make no reply to the statement contained in the first subdivision other than that there is not a word in the opinion to substantiate it. We may properly make this further suggestion. The claim involved in this case was, as we have already shown, agreed by stipulation to have been “a necessary operating expense in keeping and using said railroad”, which is, of course, “continuing the business of the road”, and yet the priority asserted was denied. If counsels’ “rationale of the decision” is correct, how is the intelligence of the court which concurred in the majority opinion to be vindicated?

(e) We further quote as follows from counsels' brief:

“On the other hand, where there has been no diversion, the creditor must establish the existence of some ‘special equity’, to use Judge Holmes’ expression. This special equity always exists where the consideration furnished by the claimant has not merely benefited the mortgagee generally by adding to the value of his security, but has preserved and enhanced the value of its security in a special sense, by assisting in keeping trains moving on the road.”

As we take up these statements, one by one, we are more and more puzzled as to how they should be treated. There is not a word in the opinion to the effect that those who keep trains moving on the road are entitled to a special equity; there is not a word in the opinion which suggests a distinction between supplies necessary to the business of the road and betterments as the basis of the court’s opinion. The word “betterments” is, as we have shown, not used in the opinion. Our only reply to counsel can, in the very nature of things, therefore, be that the statements just considered are not consistent with the facts.

In the *Gregg* case, the claim considered was for supplies used in the road’s operation. In our case, the claims are for supplies used and labor employed in the operation of the Ocean Shore Railway Company. The *Gregg* case is direct authority that the judgment of the lower court should be reversed in so far as the supply claimants are concerned, namely, those whose names appear on Exhibit B.

It has been expressly held by the Supreme Court that there can be no distinction logically made between the rights of labor claimants and supply claimants.

Union Trust Co. v. Illinois Midland Ry. Co.,
117 U. S. 434; 29 L. Ed. 963.

This principle was acknowledged as correct by the lower court in its opinion (Record, page 104) and is the subject of an extended discussion by the master. (Master's Report, page 38; Master's Report on the Law, page 81.)

Before proceeding to other branches of the argument, we desire to meet counsels' criticism of the rule announced by Mr. Justice Holmes, that priorities will be disallowed unless there has been a diversion of current income, or the payment of claims is shown to be indispensable to the continued operation of the trust property. It is argued that if, aside from instances of diversion, priorities may be allowed only when a necessity for payment, from the viewpoint of the court and the property, is made to appear, those who serve faithfully after a receiver has been appointed will be put in a less advantageous position than those who stop work, and that it is illogical to say that a claim acquires additional merit because of something happening long after its accrual. If priorities of the character of those considered in the *Miltenberger* case and referred to by Mr. Justice Holmes in the *Gregg* case were awarded because of any equity of claimants, the argument might deserve consideration, but the fact is, that when payments of this kind are made, they are not made because of any

equities of claimants, but they are ordered paid, if payment is actually ordered, because the court, in its administration of the properties and as a matter of sound business judgment, considers it advisable that they be paid. If, therefore, the court deems it, from the viewpoint of the property, unnecessary to make such payments, the claimants have no standing in enforcing them. Payments of this character, if made, are virtually an expense of the receivership incurred in the preservation of the properties, and the equity of claimants is in no way a consideration for such payment.

It may be true, as counsel suggest, that a road can best be kept in operation, and the public best be served, if those who stay at their posts are "assured by a rule of law that they will be paid at all hazards." But courts have encountered obstacles in the application of this rule which counsel have not observed. Those obstacles are the rights of the bondholders. The contracts upon which bonds rest cannot be lightly invalidated, and it is as much the court's duty to protect those who have advanced money with which the road was built as it is those who have furnished supplies for its operation. The court's obligation is to protect the trust *res*; such protection does not consist in taking from any lienholder, for the benefit of the public or anyone else, rights to which he is entitled. The opinion of Mr. Justice Lurton, speaking for the Court of Appeals in

Gregg v. Mercantile Trust Co., 109 Fed. 220,

is sufficient answer to the suggestion. It is there said:

"The displacement of mortgage liens cannot be justified upon any line of reasoning which assumes

that one class of creditors may be deprived of the benefits of their contract liens for the benefit of another upon the ground that the public interests are thereby subserved by the maintenance of a railway for the public convenience. Such a position antagonizes the constitutional principle that private property shall not be taken for the public benefit without compensation. The public character of such companies is only considered as one of the factors in arriving at the conclusion that the mortgagee of the income contracts only in respect to net income."

Referring to the doctrine of diversion, Judge Simon-
ton says as follows in:

Finance Co. v. Charleston Ry. Co., 48 Fed. 189:

"Necessarily this equity springs out of, depends entirely on, the diversion. Were it not for this diversion,—this taking of the money justly applicable to one class and using it for the benefit of another,—the equity could not exist. If there be no earnings, or if the earnings are insufficient to pay expenses, and there be no permanent improvements made, and no interest whatever paid, upon no principle of law or equity could the bondholder be made to pay out of his own property the debts of the common debtor. This would be not only a thorough disregard of the sanctity of a contract obligation, (*Kneeland v. Trust Co.*, 136 U. S. 97, 10 Sup. Ct. Rep. 950), it would be confiscation of property."

THE EARLIER SUPREME COURT DECISIONS.

It is argued by counsel (pages 18 to 28) that the rule contended for by them has been applied or approved in the following decisions of the Supreme Court of the United States:

Miltenberger v. Logansport Ry. Co. (page 18);
Union Trust Co. v. Souther (page 20);

Union Trust Co. v. Illinois Midland (page 21);
Union Trust Co. v. Morrison (page 23);
Virginia Coal Co. v. Central R. R. Co. (page 25).

The *Miltenberger* case and the *Illinois Midland* case are discussed at considerable length in our opening brief (pages 24-34; 38-43). We have nothing to add to what we there said, and nothing that counsel have had to say in their brief, in our opinion, in any way weakens the force of those decisions as authority against their contention.

Counsel neglect to state in their review of *Union Trust Co. v. Souther* (page 20) that the sole question at issue in that case was whether the *income* of the receivership might properly be used to pay operating expenses incurred prior to the appointment of a receiver, and it was decided that such use was proper. The correctness of that principle we have at all times conceded. The only objection we have to make to the citation of that case in this discussion is that it gives the impression that the case involved liens upon corpus. It requires no more than a superficial examination of the opinion to see that this is not so.

In

Union Trust Co. v. Morrison (page 23),
the court found that there was a diversion of current income and for that reason ordered the claim paid. The court adds, as a further reason for this action, that the lower court had so ordered payment without objection from either trustee or bondholders.

The

Virginia Coal Company case (page 25),

had to do with surplus earnings, and an operating claim asserted against them. In it is discussed the rule previously laid down in the *Miltenberger* case, and later applied in the *Gregg* decision.

It is submitted that, in so far as the decisions of the Supreme Court are concerned, a clear and consistent set of rules has been announced and applied, and that, from *Fosdick v. Schall* to the *Gregg* case, priority asserted by claimants has been denied in the absence of diversion.

THE DECISIONS ON CIRCUIT.

For the decisions of the lower federal courts we cannot claim a similar unanimity. In the opinions of some of the Circuit Courts of Appeal we find, without explanation, an early application of the rule contended for by appellees and a later reversal of this rule because of the Supreme Court opinions already adverted to, while the District Court opinions are in hopeless confusion.

We stated in our opening brief (page 68) that, in this circuit, there are two circuit court decisions and one decision of this court against us, but we asserted that the rule thus sanctioned is not now that of any other court of appeals. Counsel object to this statement and offer certain criticisms of it. Let us examine these objections. (Pages 37 to 41.)

FIRST CIRCUIT:

The rule contended for by appellees was applied in
Wood v. N. Y. Ry. Co., 70 Fed. 741;

and

New England Ry. Co. v. Carnegie Steel Co., 75
Fed. 54.

Mr. Justice Holmes, in the opinion rendered by him in the *Gregg* case, referring to the *Carnegie Steel* case and the rule therein applied,—that labor and supplies may be entitled to priority over the bonded indebtedness in the absence of diversion—said:

“An impression that such a general rule was to be deduced from the decisions of this court led to an evidently unwilling application of it in *N. E. R. Co. v. Carnegie Steel Co.*, 21 C. C. A. 219, 33 U. S. App. 491, 75 Fed. 54, 58, and perhaps in other cases. But we are of opinion, for reasons that need no further statement * * * that the general rule is the other way and has been recognized as being the other way by this court.”

In

Whelan v. Enterprise Trans. Co., 175 Fed. 212,
213,

the Circuit Court for the First Circuit specifically referred to the language of Mr. Justice Holmes in the *Gregg* case, above quoted, saying:

“Even the Court of Appeals for this circuit was said by the Supreme Court to have made in *New England R. Co. v. Carnegie Steel Co.*, 75 Fed. 54, 58, 21 C. C. A. 219, ‘an evidently unwilling application’ of an erroneous impression.”

This case was affirmed by the Court of Appeals for the First Circuit.

We do not, therefore, feel that it may be legitimately contended that the doctrine announced in the two earlier cases is now the law of the First Circuit.

SECOND CIRCUIT:

In answer to the statement that the case of

Pennsylvania Steel Co. v. N. Y. City Ry. Co.,
190 Fed. 609,

does not support the construction of the *Gregg* case which we believe to be correct, we quote as follows from the opinion of the master, embodied in the court's opinion:

“With reference to the second principle asserted by counsel for the senior mortgagee, it is to be noted that, if it be correctly stated and applied, then the power of a court upon which circumstances have imposed the serious obligation of operating railroad properties or other public utilities is, if not nullified, so far curtailed as to make it dangerous for it to attempt to operate at all. It doubtless is the rule marked out in the many cases cited by counsel in support of his extension of the doctrine that only those expenditures of a corporation which the creditor would have a right to expect to have met out of current income as distinguished from those for construction, including not only betterments, but perhaps even more or less necessary repairs involving restorations of permanency can be preferred and are then payable only out of income, unless diversion be shown when they become payable out of the corpus to the displacement of prior liens. These cases are *Lackawanna Co. v. Farmers' Loan & Trust Co.*, 176 U. S. 298, 20 Sup. Ct. 363, 40 L. Ed. 475; *International*

Trust Co. v. Contracting Co., 95 Fed. 850, 37 C. C. A. 396; Illinois Trust & Savings Bank v. Doud, 105 Fed. 125, 44 C. C. A. 389, 52 L. R. A. 481; Fordyce v. Omaha R. R. Co. (C. C.), 145 Fed. 544; Street v. Maryland Ry. Co. (C. C.), 59 Fed. 25; New England R. R. Co. v. Carnegie Steel Co., 75 Fed. 54, 21 C. C. A. 219; Bound v. S. C. R. R. Co. (C. C.), 51 Fed. 58; Atlantic Trust Co. v. Dana, 128 Fed. 209, 62 C. C. A. 657; Rodgers Ballast Car Co. v. Omaha, 154 Fed. 629, 83 C. C. A. 403, to which may be added the most recent expression of the Supreme Court cited by counsel for the junior mortgagee on this question in *Gregg v. Met. Trust Co.*, 197 U. S. 183, 25 Sup. Ct. 415, 49 L. Ed. 717, in which by a divided court an indebtedness for railroad ties contracted prior to the receivership was held not to be entitled to preference, even though the receivers retained and used some of the ties; no diversion of income having been shown."

It will be seen that the rule thus laid down is the rule for which we contend.

THIRD CIRCUIT:

Counsel have said that the decisions in this circuit are admitted by us to be in favor of their contention. It would be more accurate to say that the one opinion in this circuit, a District Court opinion, supports their contention:

Lee v. Pennsylvania Traction Co., 105 Fed. 405.

There is no decision by the Court of Appeals of this circuit.

FOURTH CIRCUIT:

Counsel do not dispute the authority of the cases cited in our brief (pages 60 to 63), but claim that the

rule has been changed by two later decisions,

Virginia Passenger Co. v. Lane Bros., 174 Fed. 513;

Lee v. Pennsylvania Co., 145 Fed. 405.

The case last referred to is not a decision of the Fourth Circuit and is reported in 105 Federal, 405, instead of 145 Federal, 405. It is a decision of the District Court of the Third Circuit and has just been discussed by us in this brief.

The *Lane* case supplies unquestionable authority for our contention. It will be seen from an examination of the opinion that the case was one in which it was sought to obtain an order of court that income which was derived during a railroad receivership should be devoted to the payment of operating expenses incurred both during the receivership and prior to it, and the court ruled that such use was proper. If counsel had correctly understood the rule which we believe to be the true one, they would have seen that this case has directly applied it, holding as it does that income of the receivership, as well as that prior to it, is a fund to which creditors have the first right to resort. The *Lane* case does nothing more than repeat that rule.

The portion of the opinion upon which counsel lay particular stress is the following:

“The principle seems to be this: That every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim on the income; that the income out of which he is entitled to be paid is the net income obtained by deducting

from the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvements. In a certain limited class of cases such preferential payments have been allowed out of the corpus, but these cases need not be considered, as here the income from current receipts is more than ample for the payment of this claim. *One of the foundations of the principle is that the public interest requires that a railroad must be kept a 'going concern.' It does not depend, therefore, upon the diversion, or even upon the existence of income.'*

The statement that a railroad must be kept a going concern, and that the power of a court administering a railroad to make the payment of expenses incurred by it a prior charge, irrespective of diversion, is a fundamental principle upon which receiverships are based; and it is a rule which we have, at no place in our argument, disputed. That rule is, however, entirely different from the one contended for by appellees, that prior expenses incurred in operating the same property shall be paid ahead of the bonded debt. It is, therefore, submitted that the rule of the Fourth Circuit is unqualifiedly in harmony with the one announced by Mr. Justice Holmes in the *Gregg* case.

FIFTH CIRCUIT:

The two cases referred to by us in our discussion of the rule of this circuit are said by counsel not to support our claim that proof of diversion is necessary. In the former case,

*Farmers' Loan & Trust Co. v. Vicksbury & M.
R. Co. et al.*, 33 Fed. 778, 784,

the rule is thus referred to:

“*Fifthly*, that every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim on the income. *Sixthly*, that when the income to which the class of creditors above mentioned is entitled has, by the officers of the railroad, been applied to payment for the purchase of necessary additional grounds and rolling stock, and in making permanent repairs and improvements, such sum so diverted will be refunded out of the subsequent earnings of the road. And if, by means of taking the railroad and property out of the hands of the company, and selling them before the amount so due is paid, its payment out of the income is made impossible, it may, in a proper case, be paid out of the proceeds of the sale of the property.”

In

Clark v. Central R. R. Co., 66 Fed. 803,

a payment for supplies was asserted against corpus and the court, in considering the propriety of an allowance, said:

“It does not appear that the court, in appointing the receivers, made any provision for the payment of the intervenors’ claims, but as there is evidence in the record showing that current earnings, before the receivers were appointed, were diverted to paying interest on the bonded debt, and that after their appointment they made large, permanent improvements on the railroad property, the intervenors should be allowed payment of their claims from the corpus of the property, should the earnings in the hands of the receivers be insufficient to pay them.”

This is a correct statement of the rule as we understand it.

SIXTH CIRCUIT:

The decisions in this circuit are conceded by counsel to be in our favor.

SEVENTH CIRCUIT:

It is claimed by counsel for appellees that none of the decisions in this circuit support our contention. We believe that in this counsel are in error. The cases, to our mind, proceed entirely upon the diversion theory and emphasize the fact that, in the absence of a diversion or of a necessity for payment within the meaning of the *Gregg* case, priority will be denied.

In

Calhoun v. St. L. Ry. Co., 14 Fed. 9,

in which the asserted priority of labor and supply claimants was considered, the court said:

“But independent of this, as I understand the facts of the case, under the rule which the Supreme Court laid down in the case already referred to, these claims would be payable out of the net earnings of the road, in consequence either of those earnings having been diverted from the payment for labor performed, and supplies and materials furnished, to the discharge of a portion of the indebtedness due on the mortgages, or by the appropriation of a part of those earnings to the betterment and permanent improvement of the railway, thus adding to the security of the mortgagees; and therefore, on that account, the amount being sufficient to meet the sum due on these various claims, they should be paid.”

In

Thomas v. Peoria Ry. Co., 36 Fed. 808,

the principle heretofore discussed is clearly laid down.

The court announces that allowance will be made only when income has been diverted and then only to the extent of the diversion, calling attention, however, to the exception to this rule first discussed in the *Miltenberger* case, and later emphasized by Mr. Justice Holmes in the *Gregg* decision. The case, it is submitted, is strong authority for the rule contended for by us.

From

Farmers' Loan and Trust Co. v. Green Bay Ry. Co., 45 Fed. 664, 665,

we quote as follows:

“The principle upon which equity acts in allowing, with respect to certain claims, priority of payment over precedent mortgage in the case of railways is settled by repeated adjudications of the Supreme Court. The gross income arising from the operation of a railway should be first applied to the payment of the expenses of operation, proper equipment, and needful improvements. If the income be diverted to the payment of bonded interest, in disregard of the payment of such expenses, there should be restoration to original equitable right. Failing diversion, there can be no restoration. The amount of restoration is dependent upon the amount of diversion. The power rests upon the fact of diversion of a fund belonging in equity to the general creditors, or some of them.”

EIGHTH CIRCUIT:

In this circuit it is conceded by counsel for appellees that the rule is that contended for by us.

NINTH CIRCUIT:

In this circuit, as we have already said, it has been held that the claims of laborers and those who furnished

supplies during the six months' period preceding the appointment of a receiver are entitled to payment out of the property before the mortgage debt is paid, in the absence of diversion. The cases thus referred to are fully discussed in our opening brief (pages 68 to 73).

It is submitted that the rule consistently followed by the Supreme Court, and the present rule of all Courts of Appeal, other than that of this circuit, is that pre-receivership debts will not be paid out of the corpus of the property in priority to the bonded indebtedness unless there has been a diversion of current income, or unless the payment of such claims by the receiver is shown to be indispensable to the continued operation of the property. We can no more fittingly close this portion of our argument than by referring to the conclusions of the master upon the general subject here considered. (Master's Report on the Law, pages 81, 82 and 83.)

“In this condition of the law of this circuit are labor claims incurred in the operation of the road entitled to priority out of the corpus, irrespective of diversion, or are they ruled by the decision in *Gregg v. Metropolitan Trust Company*? It must, of course, be admitted that the *Gregg* case did not concern labor claims, and that if a distinction can logically be made it should be made so as to harmonize with the decisions heretofore rendered in this circuit. It will not do merely to point out that it is a different class of claims. A due respect for the controlling authority of the Supreme Court in matters of general equity jurisprudence requires

that its decisions shall be followed according to the principles announced, without creating distinctions that present no variation of principle, but operate merely as evasions. One's human instinct is strong to make such a distinction and allow laborers' claims as presenting circumstances of unusually meritorious service. Yet it must be remembered that the chancellor is not an almoner; he cannot allow mere kindness to influence his judgment. * * * The Miltenberger case has been authoritatively determined as a case of necessity of payment, and the Supreme Court intimates, also, that diversion was present, and by inference, that if it was not present the case would not be approved as comporting with the true theory. There is left only the Illinois Midland case as an authority. That also has been explained by the Supreme Court as a case of diversion, and supported on that ground in its latest expression of the doctrine in the case of *Gregg v. Metropolitan Trust Company*. Justice Holmes also adverts to the fact that the labor claims were allowed in the Illinois Midland case without special discussion, and to the fact that it was decided expressly in accordance with the principles in the Miltenberger case. If, therefore, these two cases could, prior to the *Gregg* case, have been considered authorities in favor of the allowance of six months labor claims out of the corpus independent of diversion, they must now, since this latest decision, be considered qualified and restricted so that allowances can be made only out of income or out of corpus after diversion; or they may be paid by the receiver if the necessity arises during his administration, or, obviously, if the trustee consents.

It would appear, therefore, that the law of this circuit as regards laborers in the operating depart-

ment established in the Woodbridge Canal Company case has been changed and definitely fixed by the Supreme Court in the Gregg case. The views of Justice McKenna founded on what I have called for the purposes of this discussion the 'going concern' theory,—granting to laborers in operation a priority by reason of the intrinsic merit of their services in keeping the railroad a going concern,—first expressed by him in the Woodbridge Canal Company case and later amplified and urged with much convincing force in the dissenting opinion in the Gregg case, have been definitely rejected by the Supreme Court."

II.

THE TIME OF DIVERSION.

In so far as our argument, that no claimant can profit by a diversion unless he shows that a diversion occurred after his indebtedness became payable, is concerned, there is nothing in either the brief of Messrs. Goodfellow, Eells & Orrick or of Messrs. Sullivan, Sullivan and Roche which requires an answer here. All that is said in those briefs was said in the master's report, and the theory upon which the master proceeded has already been considered by us in our opening brief. It is again submitted that, under the rules applied both by the Supreme Court and by the Courts of Appeal which have had occasion to consider the question, no claimant in a proceeding of this character is entitled to profit by a diversion or to priority against mortgaged railroad property unless the diversion occurred after his claim became payable.

III.

A MORTGAGEE'S FIRST LIEN CANNOT BE SUBORDINATED TO THE EQUITABLE LIEN OF UNSECURED CREDITORS UNLESS IT INITIATES THE FORECLOSURE AND SECURES THE APPOINTMENT OF A RECEIVER.

Counsel for appellees contend that "upon principle and by the overwhelming weight of authority" the same rules are to be applied with regard to the allowance of priorities in actions instituted by the trustee as in those commenced by parties other than the trustee, and that our argument, that no priorities may be allowed because in this case the trustee did not institute the action of foreclosure or secure the appointment of the receiver, is unsound. It is also contended that in this case the trustee did seek the aid of the court and thus subject itself to the application of the rule that he who seeks equity must do equity. We shall consider these contentions in the order named.

We have argued, at pages 81 to 94 of our opening brief, that a mortgagee claiming under a valid deed of trust has an absolute and unassailable right to resort to the corpus of the trust fund to satisfy the bonded debt, and that if he is content to rely upon that right it will not be taken from him; that, unless he applies to a court of equity for protection and help, he may not properly be forced to concede the protection afforded by his contract, and may literally enforce the provisions of the deed of trust. Messrs. Goodfellow, Eells & Orrick attack this argument in a variety of ways. They say, at page 42 of their brief, that they doubt:

“whether we seriously claim that the mortgagee would be entitled to receive the amount, returned into court after a sale, representing a diversion”.

We said at page 84 of our brief:

“It should be further observed that diversion of current income by the mortgagor has no effect upon the correctness of the rule. The very statement of the contention, that an act of the mortgagor may prejudice a previously vested right of the mortgagee, shows on its face its invalidity. The rule suggested would, if applied, obviously result in an impairment of the obligation of the trustee’s contract and would deprive him of his rights under it. He is in no way bound to see that income is, in fact, applied to the payment of creditors. He is alone concerned with the fact that his lien on income does not attach until such debts have been paid.”

We cannot improve upon this statement of the rule as we understand it, but may add that, under the circumstances here considered, the trustee’s first lien is neither subordinated nor affected by a diversion of current income.

Counsel then ask what possible difference

“it can make to the mortgagee whether he or someone else asks for the appointment of a receiver in so far as his rights to property not covered by his contract are concerned”.

This question requires two distinct answers. If it is addressed to a consideration of the relative rights of mortgagee and creditors of income not expended, we answer that the trustee’s lien attaches only to net income, and, until such net income has been realized,

the trustee has no interest in the fund. If, however, income has been expended in making additions to property which was originally covered by the deed of trust, such additions, upon familiar principles, become a part of the trust property and may be resorted to by the trustee in the enforcement of its right under its contract.

If the question be addressed to the rights of the parties to corpus, the premise upon which the question is based is clearly inapplicable to the facts here presented. It is, of course, clear that it makes no difference to the mortgagee whether he or someone else asks for the appointment of a receiver, in so far as his rights to property not covered by the contract are concerned, but it is certainly not contended that the corpus of the property is not covered by the trust deed. It is that fact which occasions the present dispute. Our problem is an adjustment of the rights of parties, one of whom holds an equitable lien upon certain property and one of whom asserts an equitable right therein, and we claim that the lien cannot be postponed unless the holder thereof has subjected himself to the operation of the "do equity" rule. He must take the corpus of the property as he finds it, and if to that corpus additions have been made by anyone, that fact does not prevent a realization by him from the security upon which he originally relied.

It is then asserted that courts of equity are not so powerless that they can give to one class of creditors that to which they are admittedly entitled only when the representative of another class invokes jurisdiction.

It must, we feel, be unnecessary to point out that the very premise that creditors are admittedly entitled to share in the proceeds of the sale, regardless of existing prior liens, assumes the very point in controversy. It is our contention that they have no right to so share unless the action is commenced by the trustee. It is equally apparent that the further argument concededly and necessarily predicated upon the one just considered—that secured creditors would become the owners of that to which they were never entitled merely by “standing away” from a court of equity (an expression attributed by counsel to us, but which we respectfully suggest we have never employed)—assumes a prior right of unsecured creditors, which we believe the cases show they do not have, and which it has been our aim in this brief to contest.

Having made these, to our minds, unconvincing criticisms of the principle advanced, counsel then proceed to state that the authorities

“broadly declare that, irrespective of the question of diversion and irrespective of who may or may not be the plaintiff in the proceeding, priority over the mortgage indebtedness may be allowed out of corpus to claims which, because they were necessary to the business of the road, are regarded as particularly meritorious”.

This unqualified statement is followed first by a discussion of the cases cited by us in our brief and then by others which are deemed by counsel determinative of the question here raised. We shall follow the same order in our examination.

Counsel first consider the case of

Fosdick v. Schall, 99 U. S. 235,

and declare that that case does not sustain our contention. They say:

“The claim in its nature was clearly not preferred, and it was for this reason and not upon the ground that Schall’s petition in intervention was filed in a proceeding instituted by a creditor that the claim was denied preference. The sentence in the opinion which was relied upon by opposing counsel, to the effect that if a mortgagee asks no favors he need grant none, was clearly *obiter dictum*.”

We concede that the decision in this case need not have been rested upon the fact that the mortgagee was not the moving party, and was properly rested upon other grounds; but we suggest for the consideration of the court that it has been stated by counsel in this case, and that it has been generally conceded, that the Supreme Court of the United States was here laying down a set of rules for the government of future controversies which might arise; that, in nearly every case since decided by state or federal courts, *Fosdick v. Schall* has been referred to and, without qualification, followed; and that the very portion of the rule which counsel rejects as *obiter dictum* has been repeated verbatim in numerous decisions of the Supreme Court rendered from the time of *Fosdick v. Schall* until the court last spoke in the *Gregg* case.

Next referring to the *Kneeland* case, counsel argue that the claim there considered was clearly non-preferential since it had been incurred in a prior receiver-

ship, and that it thus became necessary to inquire into the nature of the prior receivership, and to ascertain whether the mortgagee was responsible therefor. It is then argued that since it was found that the mortgagee was not responsible therefor, because the receiver had not been appointed at its instance, the claimant could not "lift himself" above the rule thus referred to, which denies preference in such cases to unsecured creditors.

We think we could hardly desire stronger support for our argument than this discussion by counsel. If the rule contended for is correct, namely, that the question as to who the moving party is is entirely unimportant, what possible difference can it make whether the claim in the *Kneeland* case was incurred during a prior receivership, or when there was no receivership. It is, on counsels' theory, the merit of the claim which is to count, and not the fact that one party or the other invokes the jurisdiction of the court. That principle is entirely inconsistent with the one applied by the Supreme Court in the *Kneeland* case. The same court in its later opinion, in *Virginia Coal Co. v. Central Railroad Co.*, *supra*, referring to the *Kneeland* case, stated that one of the reasons for denying priority in that case was that the receivership was at the suit of a judgment creditor and was not for the benefit of mortgage bondholders. It is suggested, in answer to this statement, and as an explanation of the reference in the latter case, that the suit there considered was instituted by the stockholders, and that the claim was for coal used in the operation of the

road and presented by a bill in intervention. The fact is entirely ignored that subsequently to the stockholders' suit the trustee commenced its action of foreclosure, and that the allowance was made in the trustee's suit, was expressly made out of *net income* of the receivership, and that, even in making such allowance, the court considered it proper to advert to the circumstances under which the allowance was refused in the *Kneeland* case.

The argument is made that the Supreme Court considered the form of the proceeding in which the receiver was appointed an immaterial factor, because it said it is immaterial whether the expenditures for betterments were made by the receivers under the stockholders' bill or under the bill filed by the company. We are unable to appreciate the bearing of this argument upon the problem here considered. In the *Coal Company* case, the payment was authorized to be made out of surplus income of the trustee's receivership, and the inquiry as to who the moving party was is in no way pertinent. In such a case a creditor has a right to payment out of surplus income, and the trustee has no right to income until creditors have been paid.

In

Finance Co. v. Charleston Ry. Co., 49 Fed. 693, our argument receives direct support. It is there shown that the whole theory upon which the court proceeds is that the trustee, by invoking the aid of a court of equity, will be made to do equity. The court says:

“As I understand the current of cases which began with *Fosdick v. Schall*, the rule is this:

When holders of railroad bonds, secured by mortgage, come into a court of equity, and ask not only the foreclosure of the mortgage, but also the appointment of a receiver, into whose hands the corporation shall be compelled to deliver all its property, the court, as a condition precedent to granting this last request, can impose terms in reference to the payment from the income during the receivership of such outstanding claims as address themselves peculiarly to the protection of the court. Ordinarily a mortgagor is entitled to the possession of his property until the execution of a decree for foreclosure. When the mortgagor is a railroad company, the employer of many persons on weekly wages, both the employer and employed can enter into engagements relying upon this normal condition. If, therefore, the court, at the instance of mortgage creditors, interrupts the possession of the railroad company, and suddenly removes the employer from control of current earnings, it may well see to it that the employed are not put at a disadvantage, or be made to suffer from this unexpected change. Without considering liens or equities, acting only in its discretion, it imposes upon the suitors, as the condition of granting their request, that such employes be paid, not only accruing wages, but such as have accrued within a reasonable period. This is not a right vested in the employes, or an equity administered in their favor. It is a personal protection given to them by the court *ex gratia*, moved thereto by the fact that this class depend upon their daily labor for their daily food.

* * * Dealing with the interest of mortgagees in railroad property, we encounter vested rights. They cannot be displaced upon any mere idea of right, or on any refined notions of equity. In managing the property, the court is not the owner, nor can it entertain sentiments of benevolence or humanity in disbursing the funds,—luxuries in which the owner alone can indulge.”

In

Clyde v. Richmond, 56 Fed. 539,

the court said:

“This equity, as it is called, is not enforced when the mortgage creditors are not the parties asking relief and the appointment of the receiver,”

and the petition of a creditor was dismissed upon that ground; and further declares that

“The displacement of a lien secured by contract is a serious thing and it would appear that the Supreme Court of the United States is coming to the conclusion that the doctrine originating in *Fosdick v. Schall*, and applied in the late cases, should not be extended.”

The same statement of the general rule is found in

St. Louis S. W. Ry. Co. v. Holbrook, 73 Fed. 115,

from the opinion in which, delivered by Judge McCormick, we quote as follows:

“The second question, we think, must also be answered in the affirmative. The reasoning in the opinion in the Kneeland cases, 136 U. S. 89, 10 Sup. Ct. 950, the review therein of the former decisions of that court, and the conclusions announced on the issues involved in that case, seem to require that, *when mortgage creditors ask a court of equity to take possession of such property and operate it*, they consent to have all the liabilities resulting from such operation take precedence of their prior contract liens, which they are seeking by the proceeding to enforce.”

Judge Colt, in considering the question presented in

New England R. R. Co. v. Carnegie Steel Co.,

75 Fed. 59,

recognizes the application of this rule in the following language:

“What would have been the conclusion if the trustees of the second mortgage had not asked for a receiver, and had not submitted to the order of September 8, 1894, * * * we need not determine.”

Counsel have dismissed, without comment or consideration of any kind, the case of

Bound v. So. Carolina Ry. Co., 47 Fed. 30,

which is referred to at pages 88 to 90 of our brief. We challenged counsel at the time that brief was filed to explain the result reached in that opinion other than on the ground herein contended for by us. We repeated the challenge at the oral argument, and there has been no reply. The rule of that case is directly founded upon the doctrine applied in *Fosdick v. Schall* and the *Kneeland* case, and is in accordance with the rules since followed by the Supreme Court.

We now ask the court to consider the cases which counsel have said:

“Broadly declare that, irrespective of the question of diversion and of who may be the plaintiff in the proceeding, priority may be allowed out of corpus.”

Counsel refer to the following authorities:

30 American Law Journal, 168;

Union Trust Co. v. Illinois Midland Co., *supra*;

Sage v. Memphis, 125 U. S. 375;

Southern Ry. Co. v. Carnegie Steel Co., 76 Fed. 492;

Veatch v. American Co., 84 Fed. 274.

The statement by Judge Caldwell in the *American Law Journal* case requires only an examination of the quotation itself to show that the rule referred to was the one that, when a trustee applies for the appointment of a receiver, it is proper for the court, as a condition of making the appointment, to require that unsecured indebtedness of certain kinds be paid, and that, unless the mortgagee assents to this requirement, the appointment should be refused. It is directly in line with the argument which we are here advancing.

The *Illinois Midland* case counsel themselves concede shows a situation in which mortgagees commenced the actions of foreclosure in which the priorities considered were allowed. That concession makes a further discussion of the case useless. When the trustee applied for the appointment of a receiver, invoked the aid of the court, subjected itself to the operation of the rule that he who seeks equity must do equity, it made it possible and proper for the court to order allowances to unsecured creditors. In this connection, counsel quote, in italics, as follows from the opinion:

“This bill was quite sufficient to enable a court of equity to administer the property and marshal the debts including those due to mortgage bondholders, making proper parties before adjudging the merits.”

We understand that statement to be merely the declaration of the general principle that a court of equity “will administer the property and marshal the debts”. A stockholders’ suit is sufficient to enable a court to accomplish this result, appoint a receiver, and dis-

tribute the property to those entitled thereto, including bondholders, stockholders, and creditors. That, however, is, we think, no authority for the contention of counsel, that an allowance to unsecured creditors is authorized as against the lien of the mortgage when the suit is instituted by parties other than the mortgagee.

In *Sage v. Memphis Railway Company*, *supra*, the problem here discussed was neither considered nor determined. That suit dealt with the propriety of the appointment of a receiver at the instance of a judgment creditor, and did not discuss the question of the propriety of six months' labor or supply claims.

Southern Ry. Co. v. Carnegie Steel Co., *supra*, is a case in which the court held that *income* which accrued both before and after the receivership, as distinguished from *corpus*, should be directed to the payment of operating expenses, and that the equity of claimants in that fund is stronger when the receiver is appointed at the request of stockholders than when at the request of the mortgagee. The argument is that creditors having an established right in this fund, a stockholders' suit could not possibly, under any theory, diminish it; that while creditors have, as against the mortgagee, unquestioned rights in income, those rights are not so strong against the mortgagee as they are against stockholders, because the trustee's contract in terms covers the very *res* to which the creditors claim a right to resort. The mortgagee's right to the corpus of the property, which is unquestioned and unqualified, is not

considered in this case. The court had not before it the question of priorities against corpus.

The *Veatch* case has no bearing upon the questions here presented.

The brief of Messrs. Sullivan, Sullivan & Roche throws no additional light upon this problem. It deals almost exclusively with the jurisdiction of the court to determine the questions presented and to distribute the fund. That jurisdiction we have at all times, and without qualification, conceded. No cases other than those previously discussed are referred to, excepting

Illinois T. & S. Bank v. Pac. Ry. Co., 115 Cal. 285.

The decision in this case was rendered by Judge Van Fleet while a member of the Supreme Court of the State of California. The case does no more than hold that expenses and obligations *incurred by the receiver* are burdens on the property itself and may be ordered paid by the court, irrespective of who may be determined to be its other owner, or who may invoke the receivership. This is, of course, conceded.

Counsel for appellees have not only failed to cite one case in support of the proposition that an allowance out of corpus is proper where the receivership is at the instance of a party other than the mortgagee, but they have likewise failed to suggest a reason why the rule contended for by them should be applied. We submit that there is one reason, and one reason alone, why the priority of the mortgagee's lien upon corpus should be subordinated, and that is that he has sought the aid of a court of equity and may be forced to

make concessions to it. This brings us to the last point to be considered: Did the trustee in this case seek such aid and thus subject itself to the operation of the rule?

Counsel have but little to say upon this subject.

“It is idle for appellants to claim that the trustee might have enforced its security without the aid of the court. Technically and formally, the deed of trust or mortgage authorized it to do this, but as a practical matter it did not possess the power; for without a decree no purchaser would have taken the property. To have done so would merely have been to invite innumerable law suits. The trustee was therefore obliged to seek and obtain the aid of the court in *some* proceeding, and it did this in the present one. * * * Whether the sale was made upon the petition of the trustee or not is wholly immaterial. It, at least, applied for and obtained substantial relief in the proceeding.” (Page 55.)

It is conceded that the trustee had authority to sell the property in question without a foreclosure; that the summary right of sale was given to it under the terms of the trust deed; that it had proceeded to advertise the properties for sale in accordance with the provisions of the trust deed; that it was thereafter served with an order to show cause why the property should not be sold in the proceeding initiated at the instance of a judgment creditor and in which the receiver had been appointed; that it appeared in the latter proceeding and protested against the sale which the receiver proposed to make; that it eventually made

the sale itself under order of court, and that the sale was confirmed by the court in which the receiver was appointed. There is no pretense that it instituted the action of foreclosure, that it secured the appointment of a receiver, or that it did anything except, rather imperfectly, protect itself against an adverse proceeding. That this does not subject a trustee to the operation of the rule herein considered at some length is plain on the authorities as well as upon principle. It would indeed be an anomaly if by making a party a defendant and requiring him, for his protection, to assert his rights, it were possible to later insist that that same party had invoked the aid of the court and thus subjected himself to the application of the "do equity" rule. Not only is there no case holding that this is so, but there are numerous authorities to the contrary.

We need do no more than refer the court to the decisions considered in our opening brief at page 93, in which it is expressly held that, even had the trustee filed a cross bill, the court would have considered that

"as a kind of defense, a proceeding adopted by the party because he has been brought into court by the subpoena, and adopted in order that his whole right be adjudicated, since the plaintiff has forced him to put a part in adjudication".

This being so, the same equity does not arise and may not be asserted against the first mortgage bondholders as against the parties who invoked the receivership proceedings.

It is submitted that the decree of July 18, 1913, should therefore be reversed.

Respectfully submitted,

EDWARD J. McCUTCHEN,

GAVIN McNAB,

A. CRAWFORD GREENE,

*Attorneys for Appellants, Charles C. Moore,
F. W. Bradley, Maurice Schweitzer, R. D.
Robbins and Walter S. Martin.*

McCUTCHEN, OLNEY & WILLARD,

Of Counsel.

No. 2353

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CHARLES C. MOORE, F. W. BRADLEY,
MAURICE SCHWEITZER, R. D. ROB-
BINS, and WALTER S. MARTIN,

Intervenors and Appellants,

vs.

F. L. DONAHOO et al.,

Appellees.

PETITION FOR A REHEARING ON BEHALF OF INTERVENORS AND APPELLANTS.

*To the Honorable William B. Gilbert, Presiding Judge,
and the Associate Judges of the United States Cir-
cuit Court of Appeals for the Ninth Circuit:*

Charles C Moore, F. W. Bradley, Maurice Schweitzer, R. D. Robbins and Walter S. Martin, intervenors and appellants herein, respectfully ask for a rehearing in this case.

The facts involved in the determination of this appeal were fully discussed in our briefs, and we shall, with-

out further introduction, proceed to a consideration of the grounds upon which this petition is based.

THE DIRECTION THAT INTEREST SHALL BE PAID TO CLAIMANTS FROM THE DATE THE PROPERTY WAS TRANSFERRED.

The last paragraph of the court's opinion is as follows:

“Accordingly, the cause will be remanded with directions to modify the decree by limiting its operation to the \$30,000 fund to which is to be added interest at the rate of 7% per annum from the date the property was transferred to the appellants. Costs to appellants.”

We cannot but feel that the designation of “the date the property was transferred”, as the time from which appellants should be liable for interest on the claims allowed, was inadvertently made. The question, thus raised, was not referred to in the briefs, and is now for the first time discussed before this court.

That this feature of the opinion dealing with the allowance of interest is erroneous, is shown by decisions of the Supreme Court, as well as those of other tribunals, squarely in point.

It will be remembered that the Master's report was identical, as to its provisions, with the relief accorded in the opinion recently filed by this court, except that the Master recommended, after referring to certain claims not here involved, that

“no interest should be allowed on any claim since it accrued. This is on the theory of *Thomas v.*

Western Car Company, 149 U. S. 95. I recommend to the Court, however, that the decree upon this report should contain provision for the allowance of interest after a named date, which should either be the date of the Master's signing and filing his final report, or the date of the Court's decree thereon,—as to which I express no recommendation."

The District Court overruled the Master's report so far as the payment of labor and material claimants was concerned, increased the amount awarded to each claimant, and provided that "interest from the date of the filing of this decree at the rate of 7%" be paid. (Tr. 116, 117.)

In other words, the Master and the lower court were of the opinion that interest on all claims considered on this appeal should start to run from the date upon which the decree was entered (July 18, 1913), while this court has decided that it should commence to run on February 1, 1911. This result was reached, notwithstanding the fact that the court, at the same time, determined not only that \$30,000 was the limit of the diversion and, therefore, of the fund to which claimants might resort, but also that the present judgment affords the first opportunity appellants have had to discharge their indebtedness by paying the amounts which this court has found they owed, because it is the first time that a tender of those amounts would effect a discharge of the claims. The court has, it must be conceded, penalized appellants for not paying to claimants on February 1, 1911, sixty per cent of the face of their claims, when claimants would not accept that percentage and were insisting—and insisting successfully in the lower court

—that they were entitled to payment of their claims *in toto*. Why should appellants suffer for the delay occasioned by claimants' insistence upon receiving an amount to which they were not entitled, or why should they reimburse claimants for a postponement of payment resulting from the error of the lower court? That appellants should not be so penalized is, we submit, firmly established. It is the unquestioned rule that, after the property of an insolvent is *in custodia legis*, interest will not be allowed on debts payable out of the fund realized from the sale unless the fund has so increased that interest may be paid to all creditors of equal dignity; that "the delay in distribution" is held to be "the act of the law" and "a necessary incident to the settlement of the estate". It has been conclusively determined that interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets; that, as between creditors, no interest should be allowed during the process of administration and the delay necessarily resulting therefrom, because the assets are equitably their assets, the administration is for their benefit, and the delay is necessary to enable them to take action to present their claims in proper form, as well as to enable the court to effect a proper distribution. While it is true that, in the ordinary case of money found to be owing,—a situation usually covered in most of the states by statutory provision—interest is allowed from the time the obligation to pay matured and remained unpaid, our case, as the authorities show, not only does not come

within that rule, but is governed by a distinct and well-recognized exception to it.

The leading case upon this subject is

Thomas v. Western Car Co., 149 U. S. 94, 116;
37 L. Ed. 663.

In that case, certain claims for car rental and for damage suffered by cars during the management of the railroad under consideration, while operated by the receiver, were held to be entitled to priority of payment as against the bondholders. The car company insisted in the lower court and in the Court of Appeals that it was entitled to a larger amount on account of its claims than that awarded by the Supreme Court. As to the demand of the company for interest on these claims, the Supreme Court, speaking through Mr. Justice Shiras, said:

“The final matter of contention is the allowance of interest. We think the court below was plainly right in rejecting the car company’s claim for interest based upon the statute of Illinois, prescribing interest at the rate of six per cent per annum for moneys after they become due on ‘any bond, bill, promissory note, or other instrument of writing’. But the learned judge was of opinion that some allowance of interest should be made, because of what he deems to have been a vexatious and unreasonable delay in the payment of what was justly due the car company. As against this view of the case it is urged that the delay was occasioned by resisting demands made by the car company, which the result of the litigation shows were excessive, if not extortionate.

“We cannot agree that a penalty in the name of interest should be inflicted upon the owners of the

mortgage lien for resisting claims which we have disallowed. As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. *Williams v. American Bank*, 4 Met. 323; *Thomas v. Minot*, 10 Gray 263. We see no reason in departing from this rule in a case like the present, where such a claim would be paid out of moneys that fall far short of paying the mortgage debt."

In

American Iron & Steel Mfg. Co. v. Seaboard Air Line Railway et al.,

decided by the Supreme Court of the United States on April 6, 1914, and reported in the Advance Sheets at page 502, Mr. Justice Lamar, speaking for the court in answer to a question certified to the Supreme Court from the United States Circuit Court of Appeals for the Fourth Circuit, said as follows:

" * * * And it is true, as held in *Tredegar Co. v. Seaboard Air Line R. Co.*, 105 C. C. A. 501, 183 Fed. 290, that as a general rule, after property of an insolvent is *in custodia legis* interest thereafter accruing is not allowed on debts payable out of the fund realized by a sale of the property. But that is not because the claims had lost their interest-bearing quality during that period, but is a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full. If all claims were of equal dignity and all bore the same rate of interest, from the date of the receivership to the date of final distribution, it would be immaterial whether the dividend was calculated on the

basis of the principal alone or of principal and interest combined. But some of the debts might carry a high rate and some a low rate, and hence inequality would result in the payment of interest which accrued during the delay incident to collecting and distributing the funds. As this delay was the act of the law, no one should thereby gain an advantage or suffer a loss. For that and like reasons, in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt."

The portion of the opinion above quoted was, it is true, not necessary to the decision, but it is important as showing a clear affirmance by the Supreme Court of the principle applied in the *Thomas case*.

It was decided by the court that interest during a receivership should be allowed on a claim for supplies sold to a railway company in Virginia on thirty days' credit (the claim, under the local law, having priority over the bonded indebtedness) where, before the credit period expired, the railway company, alleged to be insolvent, was, on its own application, placed in the hands of receivers whose appointment was continued under a bill for foreclosure by the mortgage trustee, and the property was subsequently returned to the railway company upon the success of a plan to readjust the bonded indebtedness, interest having been paid on the bonds and floating indebtedness during the entire receivership. The fund being sufficient to pay interest to all creditors, and practically all creditors except appellant having been paid interest, the payment directed in this case was clearly justified. In our case, the bondholders have never been, and never will be, paid more

than a very small fraction of the principal of their claims.

The Circuit Court of Appeals for the Fourth Circuit had occasion to consider the same question in

Tredegar Co. v. Seaboard Air Line Ry. et al., 183 Fed. 289.

Judge Dayton, who delivered the opinion, said:

“This general rule, established by these and very many other authorities, is, however, subject to an exception where the property of an insolvent debtor passes into the hands of a receiver or an assignee in insolvency, in which case the delay in distribution is held to be the act of the law and a necessary incident to the settlement of the estate. *Thomas v. Western Car Co.*, 149 U. S. 95; 13 Sup. Ct. 824; 37 L. Ed. 663; *Grand Trunk Ry. Co. v. Central Vt. Ry. Co. (C. C.)*, 91 Fed. 569; *Malcomson v. Wappoo Mills (C. C.)*, 99 Fed. 633, 635; *Solomons v. Am. B. & L. Ass’n (C. C.)*, 116 Fed. 676; *State Trust Co. v. Kansas City P. & G. R. Co. (C. C.)*, 129 Fed. 455, bottom page 458.

“Under these authorities it appears from the record before us that this case comes under this exception to the general rule touching the payment of interest, and that the court below did not err in disallowing interest from and after the appointment of the receivers.”

In

Grand Trunk Ry. Co. v. Central Vt. R. Co., 91 Fed. 569,

while discussing a similar problem, the court said:

“When the receivers were appointed, March 20, 1896, they were directed to pay claims for materials and supplies that had accrued within six months before. On May 29th, after, further payment was

stayed for classification of the claims. No one moved for any modification of the stay till January 8, 1898. Since then the stay has been modified from time to time, according to the situation of the claims and earnings as shown by the reports of the receivers, so as to allow the payment of 25 per cent. of the face of the claims twice and 50 per cent. once. The claimants now move for a further modification of the stay, or an order for the payment of interest on the claims. * * * In *Thomas v. Car Co.*, 149 U. S. 95; 13 Sup. Ct. 824, this subject was considered, and a decree for the payment of interest on such a claim in priority to mortgage liens was reversed. In delivering the opinion of the court, Mr. Justice Shiras said:

“‘As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. *Williams v. Bank*, 4 Metc. (Mass.) 317, 323; *Thomas v. Minot*, 10 Gray. 263. We see no reason in departing from this rule in a case like the present, where such a claim would be paid out of moneys that fall far short of paying the mortgage debt.’

“‘This is such a case as that, and, according to those principles, interest on these claims cannot now be properly decreed. Motion denied.’”

In

People v. American Loan & Trust Co., 65 N. E. (N. Y.) 200,

the Court of Appeals of New York was confronted with the question here raised. We quote as follows from the opinion of the court:

“ * * * If the fund in the hands of the court could have been distributed on the same day that the receiver was appointed, no claim of interest

could have arisen, for there would have been no delay and no suspension of legal remedies. The delay in distribution, however, was the act of the law itself, and was essential for various purposes, and, among others, to enable the creditors to prove their claims. 'As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds.' *Thomas v. Car Co.*, 149 U. S. 116; 13 Sup. Ct. 824; 37 L. Ed. 663. Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets. If the assets are sufficient to pay all, including interest, it must be paid, for, as against the corporation itself, interest should be allowed before the return of any surplus to the stockholders. As between the creditors themselves, however, no interest should be allowed during the process of administration, and the delay necessarily resulting therefrom, because the assets are equitably their assets, the administration is for their benefit, and the delay is necessary to enable them to take action to present their claims in proper form, as well as to enable the court to put the assets in shape for distribution.

"As the decree of dissolution relates back to the day when the court took possession of the assets, the delay is not the act or omission of the corporation, which is *civiliter mortuus*, but is owing to the law, and hence should operate neither to benefit nor prejudice any creditor. Distribution should be made as of the date when the delay began, for it was not only caused by the law, but was necessary for the protection of all classes of creditors. As between the creditors themselves, therefore, interest ceases to accrue upon their respective claims, whether preferred or unpreferred, from the day when the corporation let go and the court took hold. This rule is so simple and easy of application that it will not only tend to prevent litigation, but will stimulate all creditors to frown upon delay and to promptly call the

receiver to account. It will not induce preferred creditors to rest easy in reliance upon the expectation that they will make money through the misfortune of the corporation, and during the entire period of administration receive interest at a greater rate than they had contracted for.”

The point here considered has been before the courts of Texas in three different cases.

From

St. Louis Union Trust Co. v. St. Louis etc. Ry. Co.,
146 S. W. 348,

we quote as follows:

“(6) The sixteenth assignment complains of the allowance of legal interest on the claims from the date of the order directing payment, because the claims were open accounts. The only fund to pay creditors was the fund from the sale; and it being admittedly insufficient to pay all creditors, and the general order of distribution of the fund to creditors of November 9, 1908, not allowing interest to all creditors from that date, these particular creditors were not entitled to have interest allowed on their claims. *Atlanta Bank v. Four States Grocer Co.*, 135 S. W. 1135; *Gaston & Ayers v. Campbell & Co.*, 141 S. W. 515.”

In

Gaston & Ayres v. J. I. Campbell Co., 141 S. W.
515,

the question was determined in the following language:

“ * * * For this reason the judgment heretofore directed to be entered will be modified, so as to direct the district court to render judgment for the interveners, *Gaston & Ayres*, for the principal of the note sued on, with interest as specified in the note up to the date of the judgment, if

the company shall be found to be solvent, together with its attorney's fees; but, if said company should be found to be insolvent, then interest should be allowed up to the 14th day of February, 1908, when the receivership proceedings began, and the court is directed to enter judgment accordingly. *Thomas v. Car Co.*, 149 U. S. 95, 13 Sup. Ct. 824, 37 L. Ed. 663; *People v. Loan & Trust Co.*, 172 N. Y. 379, 65 N. E. 200; *Brazelton & Johnson v. J. I. Campbell Co.* (Civ. App.) 108 S. W. 773; *First National Bank of Houston v. J. I. Campbell Co.*, 52 Tex. Civ. App. 445, 114 S. W. 887; *Atlanta National Bank v. Four States Grocer Co.* (Civ. App.) 135 S. W. 1135."

The Court of Civil Appeals of Texas was also confronted with the same problem in

Atlanta National Bank v. Four States Grocer Co.,
135 S. W. 1135.

We quote as follows from the opinion:

"The judgment in appellee's favor on account of the notes sued on was for the sum of \$7828.48, In the motion attention is called to the fact that \$771.40 of that sum represented interest which accrued on the principal of the notes after the appointment of the receiver. The correctness of the judgment in this particular was challenged by a proper assignment, which was overlooked by us when the appeal was first considered. There is nothing in the record suggesting a reason why the general rule announced by the Supreme Court in *Thomas v. Western Car Co.*, 149 U. S. 116, 13 Sup. Ct. 824, 37 L. Ed. 663, as applicable in such cases, should not be applied here.

"The motion for a rehearing, therefore, is granted. The judgment of the court below in appellee's favor will be further reformed so as to adjudge a recovery in appellee's favor on account of the notes for the sum of \$7057.08, instead of

for the sum of \$7828.48, and, as so further reformed, it will be affirmed.”

We also cite in support of the rule thus laid down,

Solomons v. Am. Bldg. & Loan Ass'n, ¹¹⁶ ~~101~~ Fed. ⁶⁷⁶ ~~388~~.

This court has decided that, as to the fund available, claimants were entitled to \$30,000; the trustee and its successors, to the balance. Such a determination was for the first time had on September 14, 1914. Neither claimants nor appellants knew with certainty what their rights were until that date. Then, for the first time, could appellants make such payments and secure discharge from their indebtedness. Why, indeed, to quote from the language of Mr. Justice Shiras, in the *Thomas case*, should it be held that “a penalty in the name of interest should be inflicted upon the owners of the mortgage lien for resisting claims which this court has disallowed”? Why should the court, while determining that \$30,000 was the amount of diversion, and therefore the maximum fund to which claimants might resort, add to that amount a sum in excess of \$5000 under the name of interest? It is submitted that appellants should not be so penalized, and that interest should only be made payable from the time that the judgment herein appealed from is modified.

We fully appreciate that the court has given most careful consideration to the two points urged by us in our briefs as grounds for reversal of the decree *in toto*, and which it has determined were not meritorious, but

we cannot entirely ignore what we respectfully submit is a misconstruction of certain decisions of the Supreme Court.

THE APPLICATION OF THE "DO EQUITY" RULE.

It is said in the opinion:

"The real basis upon which the preference rests is thought to be the implied understanding of all the parties that such debts are to be paid out of the current income before the mortgage has any claim thereto."

Authority for this principle is found in

Fosdick v. Schall, 99 U. S. 235;

Burnham v. Bowen, 111 U. S. 776;

St. Louis etc. R. R. v. Cleveland etc. R. R., 125 U. S. 658;

Southern Ry. Co. v. Carnegie Steel Co., 176 U. S. 257.

These cases abundantly support the quotation from the opinion set forth above. From this principle, however, the court has deduced that, since the *current income* constitutes a trust fund, and since the mortgagee in taking his security impliedly agrees that laborers and materialmen may first be paid out of this fund, creditors have a definite and unassailable right in the *corpus* of the railroad property ahead of the trustee, if the company, as distinguished from the trustee, diverts this income to which claimants are entitled to look. No one of the cases cited in the opinion is authority for this conclusion, and it is distinctly said in *Fosdick v. Schall*, *supra*:

“The mortgagee has his strict rights which he may enforce in the ordinary way. If he asks no favors he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such an application always calls for the exercise of judicial discretion; and the chancellor should so mold his order that, while favoring one, injustice is not done to another. If this cannot be accomplished, the application should ordinarily be denied.”

And the other cases cited in our brief make the allowance depend entirely upon the “do equity” rule, so clearly pointed out in *Fosdick v. Schall*, as the true principle.

It seems to us that the fallacy in the reasoning of the opinion is that it makes the trustee responsible for the acts of the mortgagor over which it has no control, and as to which it has assumed no responsibility. The trustee has impliedly agreed to restrict the scope of its lien. It has not agreed to indemnify creditors for the misconduct of the mortgagor. The trustee was under no obligation to, and, in fact, it had no right to, supervise the expenditures of the railway company, and it is only concerned in such expenditures when, as a suitor before a chancellor, it may, as a condition of obtaining relief, be required to rectify improper conduct by the company, through which it has benefited. It is clear that it can be made to forego its unrestricted

lien upon the corpus of the property only as a result of some equitable principle, and we know of no such principle and find none indicated in the opinion of the court, except the one that "he who seeks equity must do equity".

To say that income is a trust fund to which creditors have the first right to resort, and to argue from that basis that if someone other than the trustee misuses that fund the trustee must indemnify claimants out of the *corpus* of the property, sanctions the application of a rule which we feel is open to serious and legitimate criticism; and it is submitted that, in view of the importance of the question involved and the state of the authorities dealing with it, it would be proper for the court to afford us an additional opportunity for the presentation of our views.

THE TIME OF DIVERSION.

The court has found, against our contention, that the time at which a diversion occurred is immaterial. As we read the opinion, it concedes that in the cases already determined in the federal courts in which this subject has been considered, the principle for which we contend has been applied, but that it should not be applied in this case. We feel that this rule ignores the very basis of the theory of diversion, opens the door to the greatest abuses when actually applied, and we believe that, when all phases of the rule are

appreciated, the court will hesitate to give to it the unqualified approval expressed in the opinion.

We respectfully request that the court set aside the decision already given in this case, and afford us an opportunity for a discussion of the questions here raised.

EDWARD J. McCUTCHEN,

GAVIN McNAB,

A. CRAWFORD GREENE,

*Attorneys for Intervenors, Appellants
and Petitioners.*

McCUTCHEN, OLNEY & WILLARD,
Of Counsel.

CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for intervenors, appellants and petitioners, in the above-entitled cause and that, in my judgment, the foregoing petition for a rehearing is well-founded in point of law as in fact, and that said petition is not interposed for delay.

A. CRAWFORD GREENE,

*Of Counsel for Intervenors,
Appellants and Petitioners.*